COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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TECHNICAL ADVICE

Technical Advice to the European Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies

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Key of terms and phrases used in this advice

TERM	Meaning in this Advice
Act	The Financial Instruments and Exchange Act (Act No 25 of 1948) related to Regulation on Credit Rating Agencies
Broker dealers	Financial instruments business operators to which reference is made in Article 38 of the Act
COODEF	Cabinet Office Ordinance on Definitions under Article 2 of the Financial instruments and Exchange Act (Ordinance of the Ministry of Finance No.14 of 1993) related to the Regulation of Credit Rating Agencies
COOFIN	Cabinet Office Ordinance on Financial Instruments Business etc (Ordinance No 52 of 2007) related to the Regulation on Credit rating agencies
DRA	Designated credit rating agency
EU Regulation	The regulation EC No 1060/2009/EC of the European Parliament and of the Council of 16th September 2009 on credit rating agencies
EU regulatory regime	The EU regulatory and supervisory framework for credit rating agencies
Guidelines	Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc, (Supplement) Guidelines for Supervision of Credit Rating Agencies
JFSA	Financial Services Agency of Japan
Japan related ratings	Credit ratings that are not non-Japan related ratings
Non –Japan related ratings	Credit ratings determined at an overseas location by a credit rating agency that is a foreign corporation and which would not be brought into Japan
Operational control systems	The measures that need to be established by the credit rating agency under Article 66-33 of the Act
Prime Minister	The Commissioner of the JFSA to whom authority is delegated under Article 194-7 of the Act.
Prohibited Act	Acts with regards to the credit rating business prohibited under Article 66-35 of the Act
Rating categories	The criteria used for setting the grades indicating the results of the assessment of credit status
Rating determination Policy	Policy and method concerning the determination of credit ratings
Rating policy	The rating determination policy and Rating provision policy set out in Articles 313 of the COOFIN
Rating provision policy	Policy and method concerning acts to provide or make available to the public the credit ratings
SESC	The Securities and Exchange Surveillance Commission
Specified Act	Any actual or potential conflict of interest to be disclosed and managed under Article 301(1)(vii) of the COOFIN
Supervisory departments	The supervisory departments of the JFSA

TERM	Meaning in this Advice
Supervisory Committee	The Committee that is responsible for the operational control systems which meets the requirements of Article 306(1)(xvii) of the COOFIN
Unofficial translation	The translations that may be subject to change and are not officially legally binding as only the Japanese text is legally binding

Section I. Executive Summary

This document sets out the technical advice of CESR in relation to the equivalence between the Japanese legal and supervisory framework and the EU regulatory regime for credit rating agencies, in accordance with the European Commission's mandate of 12th June 2009.

This assessment is based on a review of the Financial Services Agency of Japan's unofficial[1] published translations of the relevant parts of the legal texts in relation to credit rating agencies, namely (i) the Financial Instruments and Exchange Act (Act No 25 of 1948) related to the Regulation of Credit Rating Agencies, (ii) the Cabinet Office Ordinance on Financial Instruments etc related to Regulation on Credit Rating Agencies (Ordinance No 52 of 2007), (iii) the Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act related to Regulation on Credit Rating Agencies (Ordinance No 14 of 1993), and (iv) the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc (Supplement) Guidelines for Supervision of Credit Rating Agencies, as well as on explanations of relevant provisions provided by the staff of the JFSA.

The Japanese legal and regulatory framework for credit rating agencies, was introduced on the 1st of April 2010, and is intended to replace the existing designation system for credit rating agencies that Japan has had for nearly 20 years, which will expire by the 31st of December 2010.

CESR concludes that, overall, the Japanese legal and supervisory framework is equivalent to the EU regulatory regime for credit rating agencies in terms of achieving what CESR considers to be the overall objective of:

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the credit rating agencies integrity, transparency, good governance and reliability of the credit rating activities".

In coming to this conclusion, CESR has grouped the requirements of the EU Regulation into seven areas, in relation to each of which CESR has assessed the ability of the Japanese legal and supervisory framework to achieve the main objectives of the relevant EU requirements.

CESR considers the Japanese framework to be comprehensive and in many instances similar to the EU Regulation.

There are no areas where the Japanese requirements do not meet the objectives of the EU requirements, there are no short comings, and as such CESR has no recommendations to make in respect of the Japanese legal and supervisory framework as a whole for the purposes of an equivalence determination by the European Commission.

In accordance with the mandate, CESR has not taken into account any consideration of a political nature.

<u>These seven areas are:</u>

1. The scope of the regulatory and supervisory framework
2. Corporate governance
3. Conflicts of interest management
4. Organisational requirements
5. Quality of methodologies and quality of ratings
6. Disclosure
7. Effective supervision and enforcement.

1 Unofficial means that the translations may be subject to change and are not officially legally binding as only the Japanese text is legally binding.

Japanese philosophy and approach to the regulation and supervision of credit rating agencies

Before going into the specific details of the basis upon which CESR has arrived at its conclusions, CESR considers it important to highlight that the Japanese legal and supervisory framework is characterised by:

- A philosophy of transparency and pragmatism;
- A two tier system (as discussed below) that differentiates, in practice, between the use of credit ratings for regulatory and non regulatory purposes and which captures the use of all credit ratings related to Japan;
- A differentiation between Japan and non-Japan related credit ratings;
- The use of Supervisory Guidelines for Credit Rating Agencies, that act as a guide to both the supervisors and the market regarding the approach adopted in Japan for the day to day supervision of credit rating agencies and what is expected in terms of the processes and procedures that a credit rating agency has to have in place in order to be eligible for registration;
- An extensive transparency vis-à-vis the public in respect of the documents and records that the credit rating agency is legally obliged to create and retain; and
- A treatment of groups of credit rating agencies that, differently to the EU, allows such groups to leverage off certain processes and procedures that exist at a group level for the purposes of eligibility.

As mentioned in the second bullet point above, the Japanese have introduced a two tier system in relation to the regulation and supervision of credit rating agencies. The first tier relates to registration of credit rating agencies with the JFSA. Credit rating agencies have to register with the JFSA if they want to enable their ratings to be used for regulatory purposes by the cut off date of the existing designated rating agencies regime.

The second tier, which will become effective as of October 2010, provides for additional obligations on broker dealers in relation to the explanations that they have to give to their clients when soliciting transactions relating to financial instruments rated by entities that are not registered as credit rating agencies with the JFSA.

For further information regarding the Japanese philosophy and approach to the regulation and supervision of credit rating agencies see paragraphs **224** to **380 below and Box 1** paragraphs **381** to **391** below of Section IV "Assessment of Japan."

1) Scope of the regulatory and supervisory framework

CESR considers that the scope of the regulatory and supervisory framework for credit rating agencies is equivalent to that of the EU Regulation.

For a detailed explanation regarding how CESR has arrived at this conclusion, please see paragraphs **396** to **485 below and Box 6** paragraphs **486** to **490 below** of Section IV "Assessment of Japan."

2) Corporate Governance

CESR considers that, overall the Japanese legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to corporate governance, and points out that the framework includes a large majority of the requirements set out in the EU Regulation in this area.

CESR notes that:

- there is no specific provision that allocates the responsibilities of the monitoring tasks to only the independent members of the Supervisory Committee, and

- the Commissioner of the JFSA can in certain limited circumstances grant credit rating agencies an exemption in respect of the establishment of such a Committee taking, into account among other things the number of officers and employees of the credit rating agency, its nature, size and the complexity of its business and other circumstances, provided that a number of conditions are met. In addition an exemption from this requirement can be granted to foreign credit rating agencies subject to the approval of the JFSA Commissioner provided that conditions aimed at ensuring that there is solid governance for enabling the appropriateness of the credit rating agency's business are satisfied. These exemptions are discussed in paragraphs **467** to **480** below.

For a detailed explanation regarding how CESR has arrived at this conclusion, please see paragraphs **492** to **546** below and **Box 9** paragraphs **548** and **553** of Section IV "Assessment of Japan".

3) Conflicts of interest management

CESR considers that, overall, the Japanese legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to conflicts of interest management, and points out that the framework includes comprehensive provisions, the large majority of which are similar to those of the EU Regulation and in some instances even stricter.

For a detailed explanation on how CESR has arrived at its conclusion in relation to conflicts of interest management, please see paragraphs **560** to **724** below and **Box 28** paragraphs **725** to **760 below** of Section IV "Assessment of Japan".

4) Organisational requirements

CESR considers that, overall, the Japanese legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to organisational requirements, including outsourcing, record keeping and confidentiality, and points out that the framework includes provisions the large majority of which are similar to those of the EU Regulation.

Outsourcing of important operational functions is not permitted by the Japanese regulatory framework, except for the possibility for credit rating agencies registered with the JFSA and performing business as a group, subject to certain conditions discussed in paragraphs **826** to **837** below, to meet jointly the requirements concerning (a) operational control systems, (b) preparation and announcement of the rating policy, (c) record keeping and (d) preparation and disclosure of explanatory documents.

For a detailed explanation on how CESR has arrived at its conclusion in relation to organisational requirements, please see paragraphs **765** to **853** below and **Box 33** paragraphs **854** to **863** of Section IV "Assessment of Japan."

5) Quality of methodologies and quality of ratings

CESR considers that, overall, the Japanese legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to the quality of methodologies and quality of ratings, and points out that the framework includes provisions the large majority of which are similar to those of the EU Regulation.

CESR understands that there is a requirement for a credit rating agency to appoint a specific review function, and that although there is not a specific requirement for the review function to be independent from the business lines responsible for the credit rating activities, this function covers a periodic review of methodologies, models and key rating assumptions from an independent standpoint.

For a detailed explanation on how CESR has arrived at its conclusion in relation to quality of methodologies and quality of ratings, please see paragraphs **867** to **1009** below and **Box 41** paragraphs **1010** to **1032** below of Section IV "Assessment Japan."

6) Disclosure

There are two distinct types of disclosure requirements in the EU Regulation: (i) those relating to the disclosure that a credit rating agency needs to make on a rating-by-rating basis, and (ii) those relating to the credit rating agency itself.

(a) Disclosure of credit ratings

CESR considers that the Japanese legal and supervisory framework, overall, achieves the objectives of the EU requirements that relate to disclosure of credit ratings and points out that the framework includes provisions the large majority of which are similar to those of the EU Regulation.

For a detailed explanation on how CESR has arrived at its conclusion in relation to disclosure of credit ratings, please see paragraphs **1039** to **1164** below and **Box 54** paragraphs **1165 to 1189** below of Section IV "Assessment of Japan."

(b) Disclosure concerning the credit rating agency and its activities

CESR considers that, the Japanese legal and supervisory framework, overall, achieves the objectives of the EU requirements that relate to disclosure regarding the credit rating agency and its activities, and points out that the framework includes provisions the large majority of which are similar to those of the EU Regulation.

For a detailed explanation on how CESR has arrived at its conclusion in relation to disclosure concerning the credit rating agency and its activities, please see paragraphs **1192** to **1270** below and **Box 70** paragraphs **1271** to **1295** of Section IV "Assessment of Japan."

7) Effective Supervision and enforcement

CESR considers that the Japanese legal and supervisory framework ensures that the JFSA is entrusted with sufficient powers to enable effective supervision and enforcement over credit rating agencies.

For a detailed explanation on how CESR has arrived at its conclusion in relation to effective supervision and enforcement, please see paragraphs **1302** to **1392** below and **Box 71** paragraphs **1393** to **1398** below of Section IV "Assessment of Japan."

Section II. Introduction

1. The European Commission mandated CESR on 12th June 2009 to provide it with technical advice on the equivalence between the US, Canadian and Japanese legal and supervisory frameworks and the EU regulatory regime for credit rating agencies (Regulation (EC) No. 1060/2009 of the European Parliament and the Council on credit rating agencies[2]).

2. An additional mandate relating to the equivalence of the Australian legal and supervisory framework followed on 17th November 2009.

3. This report sets out CESR's advice to the European Commission in respect of the equivalence between the Japanese legal and supervisory framework and the EU regulatory regime for credit rating agencies as set out in the unofficial[3] translation of the Japanese legal and supervisory framework published by the Financial Services Agency of Japan ("JFSA") on the 31st of March of 2010.

4. In contrast to CESR's normal process when delivering its advice to the European Commission, CESR has not conducted a consultation with the market at large, given the nature of this particular advice that CESR has been asked to give and the very tight timeframe.

5. CESR therefore is using this report to not only provide its advice but to also explain in detail its approach and methodology in assessing the equivalence between 3rd country legal and supervisory frameworks and the EU regulatory regime for credit rating agencies, in order to be completely transparent and to ensure that those reading this advice can fully understand the thinking behind it.

6. Details of the EU Commission's mandate are set out in Annex I, and references to various aspects of the mandate are made throughout this advice. CESR highlights that it has been asked to:

   a) undertake a global and holistic assessment of the third country regulatory regime from a technical point of view, based on the entirety of the third country regulatory framework;

   b) describe the supervisory arrangements provided for in the third country which ensure that the regulatory framework applicable to credit rating agencies registered/authorised there is respected;

   c) identify areas where significant discrepancies exist and suggest any solutions which could be considered by the European Commission to overcome such discrepancies;

   d) focus on the differences and give its judgment on the material importance of such differences; and

   e) advise on an early warning mechanism in case of significant changes to the third country regulatory framework.

7. Section IV of this report sets out CESR's advice in relation to the points in paragraph 6 a, b and aspects of c above, and Section V deals with points c and d of paragraph 6 above.

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2 Hereinafter, "the EU Regulation".

3 Unofficial means that the translations maybe subject to change and are not officially legally binding as only the Japanese text is legally binding.

8. CESR reiterates as reflected in the European Commission's mandate, that it has been requested to focus on the differences between the third country legal and supervisory framework and the EU regulatory regime for credit rating agencies, evaluating and giving its judgment on the material importance of such differences, and in doing so, focusing on "***technical criteria"*** and "***not taking into account any considerations of a political nature"***.

9. Following CESR's advice, the European Commission will make a final decision regarding the determination of the equivalence between a third country legal and supervisory framework and the EU regulatory regime for credit rating agencies.

Purpose and use of the European Commission's equivalence decision

10. Once an equivalence decision has been made by the European Commission, it will enable certain aspects of the EU Regulation, relating to the use of credit ratings issued[4] outside the EU, to become operational, provided other conditions are met.

11. There are two methods in the EU Regulation through which credit ratings issued outside the EU can be used in the EU for regulatory purposes.[5]

12. The first method is referred to as ***certification*** and is set out in Article 5 of the EU Regulation. It will allow a third country credit rating agency, whose activities are not considered to be of systemic importance[6] to the financial stability or integrity of the financial markets of one or more Member States, to enable its credit ratings which are not considered to be of systemic importance to the financial stability or integrity of the financial markets of one of more Member States to be used in the EU for regulatory purposes.

13. A positive equivalence determination is required to enable a third country credit rating agency to apply for certification, however CESR reiterates that a determination of equivalence is one of a number of criteria that have to be met as set out in Article 5(1) of the EU Regulation. A positive equivalence determination should not be understood as meaning that a third country credit rating agency **will automatically** be granted certification and as such its credit ratings issued from such a third country may be used in the EU for regulatory purposes.

14. Only if all the other conditions set out in Article 5(1) of the EU Regulation are met, can a third country credit rating agency be granted certification.

15. These conditions are that:

    a) the credit rating agency is authorised or registered in and is subject to supervision in that third country;

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4 For an explanation of how the location of where a credit rating is issued from is to be determined see CESR Guidance on the Registration Process which will be published before the 7th of June, 2010.

5 According to Article 3(1)(g) of the EU Regulation, "regulatory purposes" means the use of credit ratings for the specific purpose of complying with Community law, as implemented by the national legislation of the Member States. Article 4(1) of the Regulation refers to the use of credit ratings for regulatory purposes by "credit institutions as defined in Directive 2006/48/EC, investments firms as defined in Directive 2004/39/EC, insurance undertakings subject to the First Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance, assurance undertakings as defined in Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance, reinsurance undertakings as defined in Directive 2005/68/EC of the European Parliament and the Council of 16 November 2005 on reinsurance, undertakings for collective investment in transferable securities (UCITS) as defined in Directive 85/611/EEC and institutions for occupational retirement provision as defined in Directive 2003/41/EC".

6 For an explanation of how systemic importance is to be assessed please see CESR Guidance on the Registration Process which was published on the 4th of June, 2010.

b) cooperation arrangements are operational;

c) the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.

16. Cooperation arrangements, as set out in Article 5(7) of the EU Regulation are necessary in order to enable home competent authorities in the EU and the relevant third country competent authority to (i) exchange information and (ii) coordinate supervision.

17. CESR points out that these coordination arrangements are in the process of being negotiated, but if there are no such arrangements in place with the relevant third country competent authority, then the conditions for certification will not legally be met and as such certification will not be possible until such arrangements are in place.

18. The second method is ***endorsement,*** through which an EU registered credit rating agency will be able to endorse credit ratings issued in a third country through the endorsement process set out in Article 4(3)-(6) of the EU Regulation.

19. This method includes a number of tests, including, among other things, that the credit rating agency has verified and is able to demonstrate on an ongoing basis to the competent authority of the home Member State that the conduct of credit rating activities by the third country credit rating agency resulting in the issuing of the credit rating to be endorsed fulfils requirements which are "as stringent as" the requirements set out in Articles 6-12 of the EU Regulation. This is known as the "as stringent as" test.

20. A positive equivalence decision by the European Commission will enable an EU registered credit rating agency to endorse credit ratings without needing to verify or demonstrate that the regulatory regime in that third country prevents interference by the competent authorities and other public authorities of that third country with the content of credit ratings and methodologies provided that the cooperation arrangements discussed in paragraph **16** above are operational.

21. In addition, in light of the "as stringent as" test that is set out in Article 4(3)(b) of the EU Regulation, explained in paragraph **19** above, the assessment according to Article 5 of the EU Regulation of the equivalence between a third country legal and supervisory framework and the EU regulatory regime for credit rating agencies will be used for the purposes of Article 4 (3)(b) for those credit rating agencies making use of the endorsement procedure for ratings used after the transition period that will end on the 7th of June 2011.

Section III. CESR's Approach To Assessing Equivalence

22. The EU Regulation has established a prescriptive and strict EU legal and supervisory framework for credit rating agencies in order to ensure that credit ratings are independent, objective, and of adequate quality in order to underpin confidence and stability in the financial markets and contribute to the protection of investors.

23. CESR recognises that, in contrast to legal and supervisory frameworks in some third countries, the EU regulatory framework for credit rating agencies is very prescriptive and detailed.

24. The philosophy and approach of the EU Regulation is front loaded and rigorous. The EU Regulation prescribes in great detail:

a) how a credit rating agency should organise itself and the types of procedures and processes it needs to have in place,
b) what corporate governance needs to be in place,
c) the skills and knowledge base of the people it should employ,
d) the presentation and method of publishing its ratings,
e) information about the credit rating agency and its activities, in order for such credit rating agency to be eligible for consideration of suitability for issuing ratings for use in the EU.

25. The EU Regulation is directly applicable in Member States. This means that the ability of Member States at a national level to exercise individual decisions is limited. For example, competent authorities cannot impose requirements regarding registration which are not imposed in the EU Regulation, however each Member State can establish the penalties and registration and or supervisory fees that will be applied by each competent authority.

26. The EU Regulation also seeks to ensure that all Member States adopt the same supervisory approach in respect of credit rating agencies. It has introduced a concept of group decision making in the form of colleges of competent authorities.

27. Applications for registration are to be examined by the home Member State competent authority jointly with the other authorities that are members of the college.

28. In addition, where the home Member State competent authority has established that a credit rating agency breaches the obligations arising from the EU Regulation, such competent authority is expected to consult the members of the relevant college before taking supervisory measures against the credit rating agencies. It is only in respect of the supervisory measures that can be imposed on a credit rating agency for breaching the obligations arising from the EU Regulation, that decisions at a national level can be taken in the absence of agreement with either the college or CESR and even then these require initial consultation with the college, and then with CESR in the absence of agreement with the college.

29. The unified approach to supervision will be reinforced once CESR becomes a European agency and is formally empowered to take over the supervisory responsibility for credit rating agencies.

30. Against this background, CESR has been tasked with assessing the equivalence of legal and supervisory frameworks – where the philosophy of how best to regulate and supervise these entities may be very different, against that of the EU Regulation.

31. As such, CESR's approach to assessing equivalence is not to expect the EU regime to be adopted in an identical manner – this is clearly unrealistic and does not reflect the principle that the same outcome can be achieved through different means.

32. The approach adopted is to take a high level and overall look at the legal and supervisory framework that is in place, the powers of those entrusted to enforce it, and their overall approach to supervision.

33. CESR has also taken into account a number of objectives that the European Commission set out in section 2.3 of its mandate. The most notable of these being, that when assessing the equivalence of the legally binding requirements that a credit rating agency in a third country has to comply with, and the nature of the effectiveness of the supervision and enforcement to which it may be subjected to:

"the priority should lie in assuring that users of ratings in the EU would benefit from equivalent protections in terms of CRA's integrity, transparency, good governance and reliability of the credit rating activities."

34. This principle has driven the method that CESR has used in assessing overall equivalence, where CESR has asked itself - **does the third country legal and supervisory framework being assessed achieve this objective?**

35. In addition, when assessing the details of any provisions – CESR has asked itself - **does the requirement that is in place achieve the same objective of the EU requirement?**

36. The European Commission's mandate also included an indicative list of areas that CESR needs to consider in its assessment as well as the regulatory principles that need to be respected in the third country regime being assessed, CESR makes reference to these in Section IV.

37. The mandate also made it clear that CESR should:

a) conduct a technical "*global and holistic*" assessment of the regulatory framework based on "*the entirety of the third country regulatory framework in that country*";

b) "*not be limited to just assessing a commitment to any international convergence initiatives*" – such as the IOSCO code of conduct;

c) *"focus on the differences between the regulatory regime established at EU level and the third country framework",* and *"evaluate and give its judgment on the material importance of such differences.*"

38. In light of the instructions set out in paragraph **37** above, in conducting its assessment CESR has not just looked at the relevant legal provisions that have been introduced for the purposes of regulating and supervising credit rating agencies in a third country, but has also looked at other areas, such as existing securities law or corporate law that may also be applicable.

39. As the assessment is global in nature and not limited to the legal requirements that may be in place, CESR has in accordance with the mandate also assessed the nature of supervision and enforcement to which a credit rating agency may be subjected to.

40. CESR also points out for completeness that the European Commission's mandate also made it clear that:

a) *"the regulatory framework of the third country must include mandatory requirements for the registered CRA's";* and

b) *"voluntary regimes are not to be considered equivalent to the regulatory and supervisory framework introduced by the CRA Regulation."*

III.1 The steps adopted by CESR in assessing equivalence

41. Having discussed in detail above the approach that CESR has adopted in carrying out its assessment of the equivalence between a third country's legal and supervisory framework and the EU regulatory regime for credit rating agencies, this part of the advice explains the steps taken by CESR in assessing equivalence.

42. In light of the fact that the assessment is technical in nature, its scope is global, and the comparison is between prescriptive detailed provisions in a regulation and a whole regulatory and supervisory framework, CESR decided to undertake a detailed analysis ensuring that it is able to exercise its judgment objectively and that the information, it used in doing so, was fully comprehensive.

43. To do this, CESR used a step by step approach as set out below.

Step 1 – Drafting a questionnaire for self assessment

44. The first step was to find out what the third country's framework is, and how it compares to the EU one.

45. CESR considered the EU Regulation and in light of its prescriptiveness and the global nature of the assessment that needs to be undertaken, drafted a questionnaire that covered all aspects of the EU Regulation, including those relating to supervision and enforcement.

46. As the third country authority responsible for the registration and supervision of credit rating agencies is clearly best placed to explain its legal and supervisory framework, the objective of the questionnaire was to enable the third country authority to assess itself against the requirements of the EU Regulation, and explain how it considers it meets the same objectives of the EU requirements in light of the inevitable differences in philosophy and approach that may be in place.

47. For full details of the staff of the JFSA's answers to the questionnaire – see Annex II and Annex IIA.

Step 2 – Establishing conditions for objectively assessing equivalence

48. In order to ensure that CESR adopted an objective approach to its assessment, it needed to establish a number of conditions that it considers have to be met by third country regulators and their regulatory and supervisory regimes:

a) Pure self regulatory regimes are insufficient for an equivalence assessment. Any assessment on the equivalence of a third country regulatory regime must be based on laws, draft laws and regulations that either are currently or will be legally binding;

b) For the successful assessment of a third country's regulatory regime it is not sufficient that the relevant rules are described in the abstract. CESR therefore required that the third country regulator provided it not only with the relevant rules and regulations itself, but also with accompanying translations into English as the functional language of CESR;

c) Unconditional assessments can only be made with regard to laws and regulations already in force. Where only draft regulations and laws exist an equivalence assessment can only be made under the condition that the draft regulations and laws will come into force as proposed. No assessment is possible until a legislative stage is reached in which, according to the third country regulator, the proposed legal texts that are being assessed will more likely than not come into force as proposed, before an equivalent decision by the European Commission is taken. If significant changes occur, the assessment will need to be revised;

d) There needs to be legal clarity regarding what a credit rating agency is, or the activities that it conducts are, and these need to broadly cover what the EU Regulation covers, including those areas where exemptions are permissible according to the third country laws and regulations. Such exemptions need to be considered in order to verify that they do not hamper the compliance with the objectives of the EU Regulation.

49. In addition to the conditions set out in paragraph **48** above, CESR also needed to take into account what the EU Regulation states regarding the assessment of equivalence, and look at what, from a legal perspective, the text of the EU Regulation sets out.

50. Article 5(6) of the EU Regulation sets out the following requirements that need to be met cumulatively by a third country regulatory system in order for it to be able to be considered as equivalent:

a) credit rating agencies in the third country are subject to authorisation or registration;

b) the regulatory regime in the third country prevents interference with the content of credit ratings and methodologies by the supervisory authorities and other public authorities of that third country;

c) credit rating agencies in the third country are subject to legally binding rules which are equivalent to those set out in Articles 6 to 12 and Annex I of the EU Regulation;

d) credit rating agencies in the third country are subject to effective supervision and enforcement on an ongoing basis.

51. The conditions listed in paragraphs **50 a), b),** and **d)** above are narrowly defined in the EU Regulation itself and as such can be assessed with relative ease. If these conditions are not met by a third country regulatory system, CESR considers that such a system **cannot be considered as equivalent**.

52. This means that if:

a) in terms of scope there is no legal clarity regarding what a credit rating agency is, or the activities that it conducts are, and the scope of coverage is not broadly speaking what is covered by the EU Regulation;

b) credit rating agencies in third countries are not subject to authorisation or registration;

c) the regulatory regime in the third country does not prevent interference by the supervisory authorities and other public authorities of that third country with the content of credit ratings and methodologies;

53. **Then CESR will not consider the third country regulatory regime to be equivalent**.

54. Having established the core fundamental conditions that need to be satisfied, the next step was to consider what needs to be in place in order to assess the requirements of the condition set out in paragraph **50 c)** above.

55. CESR considers that this condition requires that the third country regulatory regime is **equivalent with regard to the core substantive provisions of the EU Regulation** concerning independence and the avoidance of conflicts of interest, rating analysts, employees and other persons involved in the issuing of credit ratings, methodologies, models and key rating assumptions, outsourcing, disclosure and presentation of credit ratings, general and periodic disclosures, and transparency reports.

56. This means that the third country regulatory systems that do not take the same kind of regulatory approach and do not have the same detailed requirements set out in their legal system as those set out in the EU Regulation with regard to these issues may nevertheless be considered as equivalent if the regulatory system achieves similar adequate regulatory effects.

57. In order to ensure an objective, fair and transparent process in assessing equivalence, CESR went through those provisions considered relevant for assessing equivalence as set out in the questionnaire created under step 1.

58. As explained in paragraph **35** above, when assessing the equivalence of these provisions, CESR asked itself - **does the requirement that is in place achieve the same objective of the EU requirement?**

59. This assessment is reflected in detail in Section IV below of this advice.

Step 3 - Assessing the third country's regulatory and supervisory framework against the conditions

60. Having established the conditions for assessing equivalence, CESR reviewed the responses to the questionnaire, ensuring that it fully understood the responses and how the relevant authority had explained its framework. A number of meetings and conference calls were held, with many additional questions, which were not set out in the original questionnaire, being asked.

61. Since the responses to the questionnaire are to be made public in order to ensure that there is complete transparency regarding the assessment that CESR has conducted, the relevant authority was given the opportunity to update its responses to the questionnaire, following further discussion and clarification regarding either the objective of what the EU regulatory requirement was, or what the requirement meant in practice.

62. An assessment table was created in order to compare each of the third country's requirements against:

a) the conditions for assessing equivalence;

b) the requirements as set out in the EU Regulation; and

c) the relevant legal provisions that had been provided by the authority.

63. This enabled CESR to do a detailed assessment of the framework in question, identifying the similarities and differences on a provision by provision basis, establishing how the objective of the provision was covered either by law or through supervisory practice or a combination of the two; and ensuring that where requirements were stated as being embedded in legislation, that the legislation in question covered the provision.

64. Once completed, the assessment of equivalence of each provision was established, with CESR asking itself the question as explained in paragraph **35** above- **does the requirement that is in place achieve the same objective of the EU requirement?** and thereby establishing the basis of its conclusion in respect of each provision.

65. CESR then grouped the provisions into core areas establishing overall objectives for each area and then assessed whether or not the overall objectives of each of these areas were met.

66. In relation to those areas where CESR considers that there is no equivalence, CESR will highlight the differences and make suggestions regarding how the gap between these differences can be bridged.

67. For completeness, although it is not possible for the purposes of assessing the equivalence of an existing regime to take recent proposals that may or may not be adopted in the future into account, where such developments may shed light on the direction in which an existing framework may be going, reference to this will also be made.

68. For the detailed CESR assessment of the Japanese regulatory and supervisory framework please see Section IV of this advice.

69. Although CESR has left it to each authority to check the accuracy of its response to the questionnaire which is annexed to this advice, CESR has ensured that both it and the third country authority have fully understood each other's framework and its requirements. Therefore, this advice is based on additional explanations and clarifications that have been provided to CESR by the staff of the JFSA in addition to the information set out in the answer.

Step 4 – Establishing the global assessment of the equivalence between the third country's legal and supervisory framework and the EU Regulatory regime for credit rating agencies

70. Once the assessment of the regulatory and supervisory framework was completed, the framework was looked at as a whole and CESR made a global assessment of the equivalence between the third country's legal and supervisory framework and the EU Regulatory regime for credit rating agencies on that basis, asking itself the question whether the framework overall enables assurance that:

"users of ratings in the EU would benefit from equivalent protections in terms of CRA's integrity, transparency, good governance and reliability of the credit rating activities."

71. For CESR's global assessment of the equivalence between the Japanese legal and supervisory framework and the EU Regulatory regime for credit rating agencies see paragraphs **1399** to **1443** and **Box 72** paragraphs **1400** to **1403** of Section V below.

III.2 The conditions that CESR has established for each provision of the EU Regulation in order to assess equivalence

72. In establishing its advice, CESR has divided the EU Regulation into a number of different sections, based on the overall objective that the provision is seeking to address.

73. These sections are discussed below and the same sub divisioning is used in the discussion of the assessment of Japan set out in the next Section IV of this advice.

74. The sections are as follows:

(A) Scope of the regulatory and supervisory framework
(B) Corporate governance
(C) Conflicts of interest management
(D) Organisational requirements
General organisational requirements
Outsourcing
Confidentiality
Record Keeping
(E) Quality of methodologies and quality of ratings
Reviewing credit ratings, methodologies, models and assumptions and information used in issuing ratings
Knowledge and experience of employees directly involved in credit rating activities
Quality of credit ratings and analysis of information used in assigning credit ratings
Quality of methodologies and changes to them
Competition
(F) Disclosure
Presentation and disclosure of credit ratings
General and periodic disclosure about the credit rating agency
(G) Effective supervision and enforcement
Divisions and offices of the JFSA responsible for the oversight and supervision of credit rating agencies
JFSA's personnel
Prohibition to influence the content of ratings and credit rating agencies' methodologies

Powers of the JFSA
Sanctions

(A) Scope of the Regulatory and supervisory framework

75. In assessing equivalence, as can be seen from Questions 1-8 and Questions 40-41 of the CESR questionnaire set out in Annex II and as discussed in paragraphs **48** to **53** above, ensuring that the nature of the legal and supervisory framework that is in place is able to meet the same overall objectives of the EU regulatory regime is key.

76. If CESR is not satisfied that the framework is able to do this, **then a positive equivalence recommendation cannot be made.**

77. As such, the following needs to be in place:

a) there has to be some form of legally binding regulatory and supervisory framework for credit rating agencies in place (Articles 4.3.f and 5.6.a of the EU Regulation);

b) credit rating agencies have to be subject to what CESR considers to be effective ongoing supervision and enforcement (for what CESR considers this to be see sub-section (G) effective supervision and enforcement paragraphs **200** to **220** below (Articles 4.3.f and 5.6.a of the EU Regulation);

c) credit rating agencies are subject to some form of registration or authorisation process (Articles 4.3.f and 5.6.a of the EU Regulation);

d) the scope of the activities of a credit rating agency that are subject to the third country legal and supervisory framework includes the scope of activities that is included in the EU regime (Article 3.1(a)(b) of the EU Regulation);

e) the relevant authority is prohibited from influencing the content of ratings and methodologies (Article 23.1 of the EU Regulation).

78. In respect of the points above, see paragraphs **200** to **220** below for a discussion regarding what CESR considers needs to be in place for effective ongoing supervision and enforcement.

79. Of the other requirements, set out in paragraph **77** above, it is point **d)** that needs further elaboration. As explained in paragraphs **48 d)** and **52 a)** above, there needs to be legal clarity regarding what a credit rating agency is, or the activities that it conducts are, and these need to broadly cover what the EU Regulation covers.

80. Where exemptions are permissible according to the third country laws and regulations, such exemptions need to be considered in order to verify that they do not hamper the compliance with the objectives of the EU Regulation.

81. Looking at the requirements of the EU Regulation, this means that the definition of credit rating agency or the activities that it conducts **do not need to be identical**, but it needs to cover the same scope of what is covered by the EU Regulation, ensuring that the credit ratings that are subject to the oversight of the third country framework in question and that could be used in the EU are covered.

82. In assessing equivalence of this aspect, CESR looked at the legal definition of what a credit rating agency is, what activities of the agency are covered and also at the nature of the exemptions that can be applied.

83. In looking at the definition of a credit rating agency, CESR considered whether or not the definition meant that individuals as opposed to legal entities could be credit rating agencies, as this could have implications for the recourse of those relying on those ratings.

84. If for example the definition of credit rating agencies is broader in scope than the EU definition, then clearly there is equivalence in relation to this aspect.

85. CESR points out that a third country regulatory and supervisory framework may not require all credit rating agencies to be registered or authorised with the relevant authority, but only those who want to enable their ratings to be used for what CESR considers to be those circumstances covered by Article 4.1 of the EU Regulation (referred to as “use for regulatory purposes” in this advice) need to be registered or authorised.

86. CESR highlights that Articles 4 and 5 of the EU Regulation make specific reference to the use of credit ratings issued in a third country for regulatory purposes in the EU and require the credit rating agency in question to be registered or authorised in that third country.

87. In addition, CESR highlights that it does not expect the concept of "use for regulatory purposes" in a third country's legal and supervisory framework to be the same.

88. In cases where the third country and supervisory and regulatory framework is broad, although CESR has been mandated to assess the third country framework as a whole, for the purposes of assessing equivalence, CESR is only focusing on those aspects of the third country framework that relate to the use of credit ratings for "regulatory purposes".

Exemptions

89. In terms of assessing the exemptions that can be applied and how the authority in question exercises its discretion in respect of these exemptions, any exemptions need to be assessed for the reasons set out below in paragraph **91** below.

90. If there are no exemptions set out in the third courtly legal and regulatory framework, then this is acceptable for the purposes of assessing equivalence because, the exemptions allowed under the EU Regulation exist in order to facilitate competition, recognising that the nature, scale, and complexity of a credit rating agency's business and the nature and range of its credit ratings, may in certain circumstances warrant that the agency can be exempted from complying with some of the EU Regulation's requirements.

91. Where exemptions are allowed, CESR has looked at what the nature of these exemptions are or can be, looking at whether or not other requirements of what CESR considers to be required of a credit rating agency are in place in order to ensure that:

"users of ratings in the EU would benefit from equivalent protections in terms of CRA's integrity, transparency, good governance and reliability of the credit rating activities."

92. Only where CESR is satisfied that the exemptions do not prevent the achievement of this objective in practice, and there is legal clarity as to how the authority will exercise its discretion in respect of applying exemptions for attaining registered or authorisation status, is equivalence said to be in place.

93. For a discussion regarding how the Japanese framework compares to these general and periodic disclosure requirements about credit rating agencies, see paragraphs **396** to **490** below.

(B) Corporate governance

94. Corporate governance is a core aspect of the EU Regulation, and its ability to achieve the objective set out in paragraph **22** above, and as such sets out a large number of detailed and prescriptive requirements in Annex I section A.

95. CESR considers that the key objectives of the EU Regulation's requirements with respect to corporate governance are to ensure that senior management is responsible and legally accountable for ensuring:

a) that credit ratings activities are independent;

b) that there is proper management of conflicts of interest; and
c) compliance with the legal requirements of the regulatory framework.

96. CESR points out that, as set out in recitals 28, 29 and 30 of the EU Regulation, corporate governance arrangements are necessary to ensure that credit ratings are independent, objective, and of adequate quality.

97. The EU Regulation sets out a number of corporate governance requirements that need to be in place in order to ensure that a credit rating agency is able to demonstrate its ability to meet these objectives, and its compliance with them.

98. In assessing the equivalence of a third country's legal and supervisory framework, CESR asked a number of questions in order to establish whether the requirements set out in Article 6.2 and Annex I Section A of the EU Regulation were in place.

99. These requirements involve the need for a credit rating agency to have:

a) an administrative or supervisory board ("board");
b) at least 2 independent members of the board tasked with monitoring the:
   I) credit rating policy;
   II) effectiveness of the internal quality control system;
   III) internal controls and measures established to deal with conflicts of interest.

100. These requirements also involve the need for a credit rating agency to ensure that:

a) the compensation of the independent members of the board is not linked to the business performance of the credit rating agency, and that their judgment can be exercised in an independent manner;
b) the term of office of the independent members of the administrative or supervisory board is for a pre-agreed fixed period and is not renewable;
c) a term limit for the independent member of the board is defined;
d) the majority of members of the board, including independent members have sufficient expertise in financial services;
e) if the credit rating agency issues credit ratings of structured finance instruments, at least one independent member and one other member of the board has in-depth knowledge and experience at a senior level of the markets in structured finance instruments;
f) in addition to the overall responsibility of the board, the independent members of the administrative or supervisory board have the specific task of monitoring:
   I) development of credit rating policy;
   II) development of the methodologies the credit rating agency uses in credit rating activities;
   III) effectiveness of internal control mechanisms in relation to credit rating activities;
   IV) effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or adequately managed and disclosed;
   V) compliance and governance processes including the efficiency of the review function.

101. CESR anticipates that there may be significant differences in the corporate governance requirements in a third country, and as such is not expecting all of the above requirements to be in place.

102. However, CESR considers that for the purposes of assessing equivalence, there needs to be some form of requirement that a corporate governance structure is in place to ensure that senior management is accountable.

103. In respect of the requirements relating to the independent directors that are tasked with monitoring certain activities, CESR considers that what is important and needs as a minimum to be in place is that there is a clear allocation of the following monitoring tasks in terms of overall responsibility to the senior management:

a) the development of credit rating policy and of the methodologies used by the credit rating agency in its credit rating activities;
b) effectiveness of the internal quality control system;
c) effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or managed and disclosed;
d) compliance and governance processes.

104. CESR points out that it considers that these monitoring tasks do not need to be carried out by senior management per se, but in order for the objective of the EU requirement to be met, what is important is that these monitoring tasks are carried out by someone independent, who is not involved in credit rating activities, and whose compensation is arranged in such a way to ensure the independence of their judgment and the absence of links to the business performance of the credit rating agency.

105. Considering the importance of the specific monitoring tasks and the overall responsibilities of senior management, these tasks and functions are to be ideally carried out by those who have sufficient expertise in financial services and, where relevant for the business of the credit rating agency, an appropriate in-depth knowledge and experience of the markets in structured finance instruments.

106. For a discussion regarding how the Japanese framework compares to these requirements see paragraphs **491** to **553** below.

(C) Conflicts of interest management

107. CESR points out that conflicts of interest management is a core requirement of the EU Regulation in order to ensure that it meets the overall objective as set out in paragraph **22** above.

108. CESR considers the objectives of the conflicts of interest management requirements of the EU Regulation are to ensure:

a) objectivity, independence, integrity, and quality of the credit ratings;
b) transparency about the credit ratings; and
c) to contribute to the protection of investors and financial markets.

109. The EU Regulation sets out a number of detailed requirements that have to be met by credit rating agencies in order to ensure that these objectives are achieved.

110. In assessing the equivalence of a third country's legal and supervisory framework, CESR asked a number of questions in order to establish whether the requirements set out in Article 6, Article 7 paragraphs 2-5, Annex I Sections A, B, and C of the EU Regulation were in place in addition to those aspects of conflicts of interest covered in the corporate governance section above.

111. These requirements involve the need for credit rating agencies to:

a) identify and eliminate or alternatively manage and disclose conflicts of interest;
b) be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities;
c) establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate, or manage and disclose any conflicts of interest;
d) identify, eliminate, or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgment of its ratings analysts, employees, and other natural persons whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuance of credit ratings and persons approving credit ratings;
e) publicly disclose the names of the rated entities or related 3rd parties from which it receives more than 5% of its annual revenue;
f) not issue a credit rating or in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex 1 Section B paragraph 3 of the EU Regulation;
g) ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party;
h) design its reporting and communication channels so as to ensure independence of related persons from the other activities of the credit rating agency carried out on a commercial basis;
i) ensure that compensation and performance evaluation of the rating analysts and persons approving the credit ratings are not linked to the amount of revenue they generate;
j) disclose any actual and potential conflicts of interest;
k) have requirements whereby those who know of illegal conduct by others report it to the compliance officer without negative consequences;
l) require that where a rating analyst terminates his or her employment and joins a rated entity, in the credit rating of which the analyst has been involved, or a financial firm, with which the rating analyst has had dealings as part of his or her duties at the credit rating agency, the credit rating agency is required to review the relevant work of the analyst preceding his departure;
m) establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

112. In addition to the above:

a) a credit rating agency is prohibited from providing consultancy or advisory services;
b) credit rating analysts or persons approving ratings are prohibited from making proposals or recommendations on the design of structured finance products about which the credit rating agency is expected to issue a rating; and
c) credit rating analysts are prohibited from being involved in the negotiation of fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.

113. In addition those persons referred to in Annex 1 Section C point 1 of the EU Regulation are prohibited from:

a) engaging in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity;
b) participating in or otherwise influencing the determination of a credit rating if those persons own financial instruments of the rated entity or any entity related to a rated entity or have had a recent employment or other business relationship with the rated entity that may cause a conflict of interest;

c) soliciting or accepting monies, gifts or favours from anyone with whom the credit rating agency does business;
d) taking key management positions with the rated entity or its related third party within 6 months after the rating.

114. Overall, as can be seen from the above requirements the EU approach to conflicts of interest management is a combination of requirements relating to how:

- the credit rating agency needs to be organised so that conflicts of interest are managed,
- to disclose certain interests which are considered to be a potential conflict,
- to prohibit the credit rating agency itself and those who are involved in the credit rating process from conducting certain activities,
- to ensure that those who are key to determining the credit rating of credit rated entities and their instruments do not establish working relationships that may result in conflict, and
- to ensure that the compensation of those involved in credit rating activities ensures the independence of their judgment.

115. This is another area where CESR recognises that the approach to this may differ in a third country for example by setting out in the law a list of prohibited activities that are considered *de facto* to be conflicts of interest and are prohibited irrespective of the procedures and processes that a credit rating agency may have in place.

116. CESR recognises that the third country laws and regulations in this area may not be as detailed or specific as those set out in the EU Regulation.

117. However, CESR points out that conflicts of interest management is fundamental to the ability of the EU Regulation to achieve its objectives and does expect, for the purposes of making an equivalence assessment, that there are robust provisions embedded into the law that cover actual or potential conflicts of interest management and disclosure.

118. As such, CESR considers that, in addition to those aspects of corporate governance set out in paragraphs **102** to **105** above, overall, the objectives of each individual conflict of interest management requirement described in paragraphs **111** to **113** above should be met through provisions embedded in the third country legal and regulatory framework, together with proper and effective supervision and enforcement.

119. However, CESR can accept the following differences:

a) disclosure regarding the names of clients from whom the credit rating agency receives more than 5% of its annual revenue can be made only to the regulator so that it can monitor and supervise how the credit rating agency is managing the conflicts that may arise in respect of these clients;

b) requirements that relate to the need to review the work of the rating analyst prior to its departure to a rated entity do not need to be in place because this duplicates other requirements that would pick this issue up;

c) requirements prohibiting certain individuals from taking key management positions with the rated entity or its related third party within 6 months after the rating – do not need to be in place because the conflict that is being addressed would be captured by other requirements;

d) requirements relating to rotation of certain individuals.

120. CESR recognises that the requirements relating to the gradual rotation of rating analysts and persons approving credit ratings is one of a number of ways in which a credit rating agency can achieve the objectives of the management of conflicts of interest requirements as set out in paragraph **108** above and the independence of rating analysts and persons approving ratings.

121. CESR also recognises that these requirements are controversial in that sense that some market players consider such requirements as having the effect of potentially damaging the quality of ratings by diluting expertise, as well as being in contradiction to those requirements relating to knowledge and experience.

122. Others, on the other hand, welcome it as they consider it a good discipline to have to ensure that knowledge and expertise is shared as well as the ensuring that the nature of the working relationship between the credit rating analysts and the rated entity remains impartial.

123. For the purposes of assessing equivalence, CESR does not consider it necessary that rotation requirements are in place in order to achieve the objective, but where there are no such requirements will expect for example the legal requirements relating to conflicts of interest management to be very robust.

124. For a discussion regarding how the Japanese framework compares to the conflicts of interest requirements see paragraphs **560** to **760** below.

(D) Organisational requirements

125. CESR considers that the overall objective of the organisational requirements is to contribute to ensuring the objectivity, independence, integrity, and quality of the credit rating activities.

126. The EU Regulation sets out a number of organisational requirements that credit rating agencies need to have in place in order to be able to demonstrate its ability to meet these objectives and compliance with them.

127. These requirements can be divided as follows:

I) General organisational requirements;
II) Outsourcing;
III) Confidentiality; and
IV) Record keeping.

D.I) General organisational requirements

128. Article 6.2 and Annex I Section A paragraph 3-6, 8, 10 of the EU Regulation requires the credit rating agency to:

a)establish adequate policies and procedures that ensure compliance of its obligations under the relevant regulation;
b)have sound administrative and accounting procedures, internal control mechanisms designed to secure compliance with decisions and procedures at all levels, effective procedures for risk assessment, effective control and safeguard arrangements for information processing systems;

c) implement and maintain decision making procedures and organisational structures that clearly and in a documented manner specify reporting lines and allocates functions and responsibilities;
d) establish and maintain a permanent and effective compliance function which operates independently;
e) employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities;
f) monitor and evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with the authorities' requirements and take appropriate measures to address any deficiencies.

129. In respect of the above requirements, CESR considers that these are necessary to facilitate the credit rating agency's ability to achieve the objectives set out in paragraph **125** above, although it does not expect the identical requirements to be hard wired into a third country's regulatory framework.

130. CESR needs to take an in depth look at what organisational requirements are in place as a package, and in addition consider the nature and extent of the supervisory and enforcement powers and practices that are in place, as discussed in Section G below.

131. Having assessed what is in place as a package, CESR considers that the overall organisational requirements must objectively achieve the purposes discussed above in order to be assessed equivalent to the EU requirements.

132. As such, for example CESR can accept that there may not be an identical requirement set out in the law to have a permanent and effective compliance function which operates independently, but it does expect the objective of this requirement to be somehow in place.

133. For an explanation of CESR's view regarding how and if the Japanese framework meets these requirements please see paragraphs **765** to **825 below**.

D.II) Outsourcing

134. Article 9 of the EU Regulation prohibits outsourcing of important operational functions in such a way so as to impair materially the quality of the credit rating agency's internal control and the ability of the authorities to supervise the credit ratings agency's compliance under the EU Regulation.

135. In assessing the equivalence of this prohibition, CESR asked a number of questions to establish:

a) if any outsourcing of important operational functions is allowed;
b) if any restrictions in respect of outsourcing exist;
c) whether or not the regulatory framework ensures that:

I) none of the outsourced functions impair the quality of the credit rating agency's internal controls; and
II) that the outsourcing does not impair the ability of the relevant authority to supervise the credit rating agency's compliance with its regulatory obligations.

136. In respect of these requirements, CESR considers that, where outsourcing is allowed in the third country, for the purposes of a positive assessment of the equivalence, the third-country regulatory

framework shall set out conditions for outsourcing aimed at ensuring that the following objectives are achieved:

a) none of the outsourced functions impair the quality of the credit rating agency's internal controls, and

b) the ability of the authority to supervise the credit rating agency's compliance with its legal obligations is not impaired.

137. In addition, CESR expects that if outsourcing is allowed:

a) there needs to be legal clarity regarding what can be outsourced; and

b) the legal responsibility for what is being outsourced shall remain with the credit rating agency.

138. For a discussion about what the Japanese outsourcing requirements are, please see paragraphs **826** to **837** below.

D.III) Confidentiality

139. Requirements relating to confidentiality are important because of the nature of the information that the credit agency and its employees have access to. There is a need to ensure that confidential information is only used for purposes related to credit rating activities and is protected from fraud, theft or misuse.

140. The EU Regulation imposes a number of confidentiality obligations on rating analysts, employees of the credit rating agency as well individuals whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in credit rating activities as well as individuals closely associated with them as set out in Article 7.3 and Annex I Section C paragraph 3 of the EU Regulation as follows:

a) to take all reasonable measures to protect property and records in possession of the credit rating agency from fraud, theft or misuse;
b) to not disclose any information about credit ratings or future ones other than to the rated entity or its related third party;
c) to keep information entrusted to the credit rating agency confidential;
d) to not use or share confidential information for trading purposes or any other purpose other than credit rating activities;

141. CESR considers these requirements to be very important for the reasons set out above, and it expects the objectives of these requirements to be met for the purposes of assessing equivalence.

142. For a discussion regarding how the Japanese framework compares to these confidentiality requirements see paragraphs **838** to **844** below.

D.IV) Record Keeping

143. Effective record keeping enables a credit rating agency to document the manner in which it meets its legal obligations, as well as allowing its regulator to supervise that this is being done.

144. Article 6.2 and Annex I Section B paragraphs 7 to 9 of the EU Regulation require credit rating agencies to keep adequate records and, where appropriate, audit trails of their credit rating activities for at least five years and make them available upon request to the competent authority.

145. CESR considers this requirement to be crucial for the purposes of establishing equivalence, but can accept that the period of time for which records need to be kept may differ from jurisdiction to jurisdiction, but whatever is in place has to be reasonable.

146. For a discussion regarding how the Japanese framework compares to these record keeping requirements see paragraphs **845** to **853** below.

(E) Quality of Methodologies and Quality of Ratings

147. In addition to the general organisational requirements referred to above, the EU Regulation sets out a number of requirements aimed at ensuring the following objectives:

a) that the methodologies, models and key rating assumptions that are used in credit rating activities are rigorous, continuous and thorough;
b) the adequate quality, integrity and thoroughness of the credit rating activities;
c) as set out in recital 7 of the EU Regulation the protection of the stability of financial markets and of investors; and
d) that ratings and methodologies are subject to validation as well as the adequate quality and thoroughness of ratings.

148. These requirements are set out in Article 6.2 - Annex I Section A paragraph 9, Article 7.1, Articles 8.2, 8.3, 8.4, 8.5, 8.6, Article 10.2 Annex I Section D.1 of the EU Regulation, and can be divided into the following areas:

I) Reviewing credit ratings, methodologies, models and assumptions and information used in issuing ratings;
II) Knowledge and experience of employees directly involved in credit rating activities;
III) Quality of credit ratings and analysis of information used in assigning credit ratings;
IV) Quality of methodologies and changes to them; and
V) Competition.

E.I) Reviewing credit ratings, methodologies, models and assumptions and information used in issuing ratings

149. The EU Regulation sets out a number of requirements dealing with the review of credit ratings, methodologies, models and assumptions as well as the need to review the information used in issuing ratings in Article 8.2, Article 8.5, Article 8.6 and Annex I Section A paragraph 9.

150. These requirements require a credit rating agency to:

a) have a review function devoted to the periodical review of methodologies, models, key rating assumptions;
b) monitor its ratings and methodologies on an on-going basis and at least annually; and
c) review the affected credit ratings as soon as possible and not later than within 6 months after the change, and in the meantime place those ratings under observation.

151. For the purposes of assessing equivalence CESR considers it important that methodologies are up-to-date and subject to a comprehensive review on a periodic basis.

152. CESR does not consider it necessary for there to be a separate review function per se for the purposes of equivalence, but that whatever requirements are in place, that these achieve a periodic review of methodologies, models, and key rating assumptions by those who are independent from those that are responsible for the development and use of these models, key rating assumptions, and models.

E.II) Knowledge and experience of employees directly involved in credit rating activities

153. The EU Regulation sets out requirements relating to the nature of the knowledge and experience of credit rating agency's employees directly involved in credit rating activities in Article 7.1.

154. This requirement is that the credit rating agency ensures that rating analysts, employees of the credit rating agency, and any other natural person directly involved in credit rating activities have appropriate knowledge and experience for the duties assigned.

155. CESR considers it important that those involved in credit rating activities have the necessary skills and knowledge to carry out their respective responsibilities, and that this is an area that needs to be covered in the relevant third country framework.

156. CESR recognises that the EU requirement has embedded a test of appropriateness, which is subjective and is something that will need to be assessed on a case-by-case basis.

157. The question for the purposes of equivalence is therefore whether embedding the "appropriateness" requirement in law means that in practice those doing the job are appropriately qualified, and who is best placed to assess this?

158. CESR considers that for the purposes of assessing equivalence, the lack of an appropriateness test in a requirement can still result in the objective of the provision being met, provided there is disclosure regarding those individuals doing the job, and the ability to take legal action where it is clear in practice that those doing it are not appropriate.

E.III) Quality of credit ratings and analysis of information used in assigning credit ratings

159. The EU Regulation sets out a number of requirements dealing with the quality of ratings and the information that credit rating analysts have to use when assigning ratings, as well as ensuring that the information is up to date and accurate.

160. These requirements are set out in Articles 8.2, 8.5, 10.2, and Annex I.DI. of the EU Regulation.

161. These requirements are:

a) to adopt, implement and enforce adequate measures to ensure that the credit ratings they issue are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies;
b) to adopt all necessary measures so that the information they use in assigning a credit rating is of sufficient quality and from reliable sources;

c) to establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings;
d) to inform the entity subject to the rating at least 12 hours before publication of the credit rating and of the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors;
e) to refrain from issuing a credit rating or withdraw an existing rating if they do not have sufficient quality information to base their ratings on; and
f) to establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

162. CESR considers these requirements are important for the purposes of achieving the objective of ensuring that the ratings being issued are robust, well founded and based on reliable information and overall are of adequate quality.

163. In establishing the equivalence of these requirements with a third country's legal and supervisory framework, CESR would not expect to see identical requirements however it would expect to see requirements that are able to achieve this objective.

164. In respect of the requirement set out in paragraph **161** c) above CESR does not consider that this needs to be addressed by a separate requirement as is the case in the EU Regulation because it expects this to be covered in the obligation to ensure that ratings are based on accurate and up to date information.

165. In respect of the requirement set out in paragraph **161** f) above, and as discussed in paragraphs **120** to **123** above, CESR does not consider it necessary that there is a specific requirement that the credit rating agency establishes a gradual rotation mechanism.

E.IV) Quality of methodologies and changes to them

166. The EU Regulation sets out a number of requirements relating to the quality of methodologies and what needs to be done when methodologies, models or key rating assumptions used in credit rating activities are changed, as set out in Article 8.3 and 8.6 (a-c) of the EU Regulation.

167. These requirements impose an obligation on credit rating agencies to:

a) use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing;
b) apply the changes in methodologies and models consistently to existing ratings; and
c) immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distributions of the affected credit ratings.

168. CESR considers that these requirements are significant in ensuring that the credit rating agency is able to achieve the overall objective of these requirements.

E.V) Competition

169. The EU Regulation has a number of requirements relating to the rating of structured finance products where the rating agency has not rated the underlying assets of the product.

170. These requirements are set out in Article 8.4 of the EU Regulation and they impose a prohibition on the credit rating agency to refuse:

a) to issue a credit rating of an entity or a financial instrument because a portion of the entity or the financial instrument had been previously rated by another credit rating agency, where a credit rating agency is using an existing credit rating prepared by another credit rating agency with respect to underlying assets or structured finance instruments;
b) to record all instances where in its credit rating process it departs from existing credit ratings prepared by another credit rating agency with respect to underlying assets or structured finance instruments providing a justification for the differing assessment.

171. CESR does not consider that these requirements need to be in place for the purposes of assessing equivalence.

172. For an explanation of CESR's view regarding how and if the Japanese framework meets the objectives of the quality of methodologies and quality of ratings requirements, please see paragraphs **867** to **1032** below.

(F) Disclosure

173. The information that has to be disclosed either to the public or the regulator in respect of credit ratings and the credit rating agency and its activities forms another set of core prescriptive requirements.

174. For the purposes of assessing equivalence, CESR has subdivided the EU Regulations disclosure requirements as follows:

I) Presentation and disclosure of credit ratings;
II) General and periodic disclosure about the credit rating agency.

F.I) Presentation and disclosure of credit ratings

175. In light of the number of presentation and disclosure of ratings requirements, for the purposes of this advice, CESR has further categorized these requirements into:

a) General provisions on the presentation and disclosure of any credit ratings; and
b) Additional requirements in respect of the presentation and disclosure of credit ratings for structured finance products.

F.I) A) GENERAL PROVISIONS ON THE PRESENTATION AND DISCLOSURE OF ANY CREDIT RATINGS

176. The EU Regulation sets out a number of detailed requirements relating to the disclosure and presentation of ratings. CESR considers that the objectives of these requirements aim at ensuring that ratings are disclosed in a timely manner and in a non-selective basis, and that adequate information is provided to the users of credit ratings in order to allow them to conduct their own due diligence when assessing whether or not to rely on those credit ratings.

177. Namely, pursuant to Article 10.1,4,5,6, Article 11.2, and Annex I, Section D, paragraph 5, of the EU Regulation, credit rating agencies are required to:

a) disclose any credit rating, as well as any decisions to discontinue a credit rating, on a non-selective basis and in a timely manner;
b) refrain from using the name of the competent authority in such a way that would indicate endorsement or approval by that authority of the credit rating or any credit rating activities of the credit rating agency;
c) disclose its policies and procedures regarding unsolicited credit ratings and ensure that unsolicited credit ratings are identified as such;
d) in the case of an unsolicited credit rating, information on whether or not the rated entity or related third party participated in the credit rating process and whether the credit rating agency had access to the accounts and other relevant internal documents of the rated entity or its related third party;
e) when announcing a credit rating, to explain in their press releases or reports the key elements underlying the credit rating; and
f) make available information on its historical performance data, including the rating transition frequency and information about credit ratings issued in the past and their changes.

178. In addition, according to Article 10.2 and Annex I, Section D, paragraphs 1, 2, 4 of the EU Regulation, credit rating agencies are required to ensure that the following information is indicated in the credit ratings:

a) the name and job title of the lead rating analysts as well as the name and the position of the person primarily responsible for approving the rating;
b) all substantially material sources used to prepare the credit rating, with an indication of whether the credit rating has been disclosed to that rated entity or its related third party and amended following that disclosure;
c) the principal methodology or methodology version that was used in determining the rating, with a reference to its comprehensive description;
d) the meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitive analysis of the relevant key rating assumptions, accompanied by an explanation of the worst-case and best-case scenario credit ratings;
e) the date of first release of the credit rating for publication as well as of its last update;
f) information on whether the credit rating concerns a new financial instrument and whether the credit rating agency is rating it for the first time; and
g) any attributes and limitations of a credit rating, and in particular to what extent the credit rating agency has examined the quality of information used in the rating process and whether it is satisfied with the quality of information it bases its rating on.

179. CESR considers that, for the purposes of assessing equivalence, overall, the objectives of each individual requirement described in paragraphs **177** to **178** above should be met through provisions embedded in the third country legal and regulatory framework, together with proper and effective supervision and enforcement.

180. However, CESR can accept the following differences:

a) decisions to discontinue a credit rating are to be disclosed, but there is no requirement to indicate the reasons for such a decision;
b) the requirement, when announcing a credit rating, for press releases or reports to indicate the key elements underlying the credit rating, provided that it is ensured that such key elements are provided to investors when ratings are announced;

c) the name and job title of the lead rating analysts as well as the name and the position of the person primarily responsible for approving the rating are not to be disclosed in the credit rating, provided that record of this information is kept;
d) credit ratings are not required to indicate whether the credit rating concerns a new financial instrument and whether the credit rating agency is rating it for the first time, since it expects this requirement to be covered through the requirement to indicate the attributes and limitations of the credit ratings that are disclosed.

F.I)B) ADDITIONAL REQUIREMENTS IN RESPECT OF THE PRESENTATION AND DISCLOSURE OF CREDIT RATINGS FOR STRUCTURED FINANCE INSTRUMENTS

181. The EU Regulation imposes additional requirements in respect of the presentation and disclosure of ratings related to structured financial instruments.

182. The aim of these requirements is to ensure that ratings for structured financial instruments are clearly identifiable as such, and that investors receive appropriate information to deal with the additional complexity of these products.

183. Namely, Article 10.3 and Annex I, Section D.II, paragraphs 3, 4 of the EU Regulation require credit rating agencies that rate structured finance instruments:

a) to ensure that credit categories attributed to those structured finance instruments are clearly differentiated by the use of a specific symbol;
b) to accompany the disclosure of methodologies, models and key rating assumptions with guidance explaining the assumptions, parameters, limits and uncertainties surrounding the models and methodologies used in such credit ratings;
c) to disclose on an on-going basis information about all structured finance products submitted to them for initial review or preliminary rating, regardless of whether a final rating has been issued.

184. In addition, credit rating agencies that rate structured financial instruments are required to provide in the relevant credit ratings the additional information set out in Annex I, Section D.II, paragraphs 1, 2 of the EU Regulation, as detailed below:

a) all information about loss and cash-flows analysis performed or relied upon by the credit rating agency as well as about expected changes in the credit rating;
b) information on whether the credit rating agency has performed any assessment concerning the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments (specifying what level of assessment) or whether the credit rating agency has relied on a third party assessment.

185. Taking into account the complexity of structured finance products, CESR considers it important, for the purposes of assessing equivalence that additional requirements are in place for the presentation and disclosure of credit ratings related to these types of products.

186. Out of the requirements set out in paragraphs **183** to **184** above, CESR considers that it shall be, as a minimum, ensured that information is disclosed about the level of assessment, if any, conducted by the credit rating agency on the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments.

187. For a discussion regarding how the Japanese framework compares to these presentation and disclosure of credit ratings requirements see paragraphs **1039** to **1189** below.

F.II) General and periodic disclosure about the credit rating agency

188. In addition to the requirements on disclosure and presentation of credit ratings, the EU Regulation imposes a number of prescriptive disclosure requirements on credit rating agencies in relation to their organization and their activities, including the methodologies they use for determining and publishing credit ratings.

189. CESR considers that the objectives of the general and periodic disclosure requirements of the EU Regulation are aimed at ensuring transparency about credit rating activities, at making information available to the public to allow it to perform an assessment on whether to rely on certain credit ratings as well as at providing information to competent authorities for the purposes of on-going supervision.

190. For the purpose of this paper, a distinction is made between:

a) General additional disclosure requirements; and
b) Periodic additional disclosure requirements, which include the information expected to be provided in the transparency reports.

F.II) A) General additional disclosure requirements

191. According to Article 11.1 and Annex I, Section E.I of the EU Regulation, a credit rating agency is required to generally disclose to the public the following information:

a) the fact that it is registered;
b) a list of ancillary services;
c) the policy of the credit rating agency concerning the publication of credit ratings and other related communications;
d) the general nature of its compensation arrangements;
e) the methodologies, and descriptions of models and key rating assumptions as well as their material changes;
f) any material modification to its systems, resources or procedures; and
g) where relevant, its code of conduct.

192. CESR recognises the importance of the disclosure of such information for the purposes of achieving the objectives referred to in paragraph **189** above. CESR considers that, for the purposes of an equivalence assessment, it is necessary to assess, whether or not as a minimum, the information referred to under letters **a)**, **b)**, **c)**, **e)**, **g)** of paragraph **191** above is disclosed to the public. CESR can accept for the purposes of equivalence that the information referred to under letters **d)** and **f)** of paragraph **191** above is provided only to the competent authority.

F.II.B) Periodic Additional disclosure requirements

193. Article 11.3 and Annex I, Section E.II paragraph 2 of the EU Regulation require credit rating agencies to provide, on an annual basis, to the competent authority:

a) a list of the 20 largest clients by revenue generated by them; and
b) a list of the clients whose contribution to the growth rate in the generation of the credit rating agency's revenue in the previous financial year exceeded the growth rate in the total revenue of the credit rating agency in that year by a factor of 1.5 times.

194. For the purposes of assessing equivalence, CESR expects the third country regulatory framework to impose some form of disclosure requirement regarding revenue generation on the credit rating agency. However, for the purposes of assessing equivalence, CESR can accept that the requirement in paragraph **193 a)** above does not need to be identical to the one set out under the EU Regulation (e.g. not covering the 20 largest clients), and that the requirement in paragraph **193 b)** above does not need to be in place in the third country.

195. In addition to these requirements, the EU Regulation (Article 11.2 and Annex I, Section E.II paragraph 1) requires credit rating agencies to make available to the public, on a half-yearly basis, data about the historical default rates of their rating categories, distinguishing between geographical areas of the issuers and whether these default rates have changed over time.

196. CESR considers that, for the purposes of an equivalence assessment, the third country legal and regulatory framework shall require credit rating agencies to disclose to the public data about historical default rates of rating categories and their changes over time. However, CESR can accept that the frequency for publication may be different, as well as that no distinction is made between the geographical areas of the issuer.

197. In addition, under Article 12 and Annex I, Section E.III of the EU Regulation, credit rating agencies are required to make the following information available to the public on an annual basis in an annual report on their Internet website:

a) a detailed description of their legal structure, ownership and revenue streams;
b) a description of the internal control mechanisms ensuring quality of their credit rating activities;
c) a description of their record keeping policy;
d) a description of their management and rotation policy;
e) statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management; and
f) the outcome of the annual internal review of their independent compliance function.

198. Whilst according to the EU Regulation these requirements need to be disclosed to the public, CESR considers disclosure to the authority is adequate for the purposes of establishing equivalence. In addition, CESR considers that it can accept that credit rating agencies are not required to disclose the statistics referred to under letter e) in paragraph **197** above.

199. For a discussion regarding how the Japanese framework compares to these general and periodic disclosure about the credit rating agencies requirements see paragraphs **1193** to **1270**.

(G) Effective supervision and enforcement

200. Article 4.3(f) and 5.6 of the EU Regulation include as preconditions for ratings issued outside the EU to be endorsable or certifiable that:

a) credit rating agencies in the third country are subject to effective supervision and enforcement on an ongoing basis (Article 5.6); and

b) the credit rating agency established in the third country is authorised or registered, and is subject to supervision in that third country (Article 4.3(f)).

201. In addition, the coordination arrangements that need to be in place in accordance with Articles 4.3(h) and 5.1(c) have to include provisions relating to the *"coordination of supervisory activities…"*

202. As explained in paragraph **51** above, CESR has established a number of preconditions for the purposes of establishing whether or not equivalence exists, and in the event that it does not consider the objectives of these requirements to be met, then such a system cannot be considered to be equivalent.

203. In assessing the nature of equivalence in this area, CESR divided these requirements into the following areas:

I) The methods that the authority has in place to ensure that it is adequately staffed;
II) The powers of the relevant authority; and
III) The nature of the penalties that can be imposed.

204. CESR points out that it is not, for the purposes of assessing equivalence, making any judgments regarding the approach that the third country regulator adopts in relation to on-going supervision, for example, whether a risk based approach is or is not a good or bad thing, but is overall looking to get comfort that the supervision that will or is being done can be or is in practice effective.

G.I) The methods that the Authority has in place to ensure that it is adequately staffed

205. The nature of supervision and enforcement that takes place in respect of monitoring and supervising the credit rating agencies' adherence to their obligations and taking action where they do not, is heavily dependent upon the number of staff that the relevant authority charged with the legal responsibility of supervising these entities has in place.

206. Article 22.2 of the EU Regulation requires that competent authorities in the EU to be adequately staffed, with regard to capacity and expertise, in order to able to apply the EU Regulation.

207. In assessing equivalence in this area, CESR does not expect to find a similar legal provision but that there will be enough staff.

208. Even at an EU level there is no standardisation between Member States in terms of what "adequate" means and the minimum number of staff or their expertise for the purposes of applying the EU Regulation, as such there is no benchmark against which CESR can assess equivalence in this area.

209. However, without the necessary staff there cannot said to be "effective supervision", as such, CESR has, in assessing equivalence, sought to understand how the regulator in question either already does, or will, in the future be organising itself, and how many staff it has or will have.

210. CESR is conscious of the fact that this is an area that may change in respect of the third country that it is assessing, but clearly if there is no thought to how supervision will in practice be carried out – then irrespective of the powers that the supervisors may have at its disposable to use, CESR cannot say that the supervision is or will be effective.

G.II) The powers of the relevant authority

211. Article 23 of the EU Regulation sets out the details of the powers that the EU competent authorities need to have in order to be able to discharge their legal duties under Article 23.3 of the EU Regulation, as well as a description of how these powers are to be exercised (Article 23.2).

212. The necessary powers that the authority need to have are the power to:

a) access to any document in any form and to receive or take a copy thereof;
b) demand information from any person and if necessary to summon and question a person with a view to obtaining information;
c) carry out on-site inspections with or without announcement;
d) require records of telephone and data traffic.

213. In addition, as set out in Article 24 of the EU Regulation, the authority in question has to be able to take the following measures against a credit rating agency following the establishment of a breach by it in respect of its obligations under the EU Regulation:

a) to withdraw the credit rating agency's registration or authorisation;
b) to prohibit the credit rating agency from temporarily issuing credit ratings;
c) to suspend the use of credit ratings issued by the credit rating agency for regulatory purposes;
d) to take appropriate measures to ensure that the credit rating agency continues to comply with its legal requirements;
e) to issue public notices where the credit rating agency is in breach of its obligations arising from the relevant regulatory framework in your jurisdiction; and
f) to refer matters for criminal prosecution to the relevant national authorities.

214. For the purposes of assessing equivalence, CESR considers that all the above powers need to be firmly embedded in the relevant law in order to be able to classify the third country regime as having effective supervision which it considers to be equivalent to that of the EU's.

215. In addition, as set out in the final paragraph of Article 23.3 of the EU Regulation the authority needs to be able to exercise these powers in respect of:

"credit rating agencies, persons involved in credit rating activities, rated entities and related third parties, third parties to whom the credit rating agencies have outsourced certain functions or activities; and person otherwise related or connected to credit rating agencies or credit rating activities."

216. As such, when assessing equivalence in this area, CESR needs to assess not only the nature of the powers that can be exercised, but also against whom these powers can be exercised in assessing whether or not the supervision is or can be "effective."

G.III) Penalties

217. Article 36 of the EU Regulation sets out that the penalties that can be imposed by each national authority need to be: "effective, proportionate and dissuasive" – but leaves it to each authority to determine what these should be.[7]

218. In addition, the EU Regulation imposes an obligation on the national authorities to disclose to the public every penalty being imposed for infringements of the EU Regulation, unless such disclosure

7 CESR will in June be issuing some guidance regarding what the nature of these penalties may be.

would seriously jeopardise the financial markets or cause disproportionate damage to the parties involved.

219. For the purposes of assessing equivalence, CESR expects that the relevant third country framework has legal provisions setting out what the penalties that can be imposed for breaches of the relevant requirements are, but does not expect these penalties to be publishable for the purposes of equivalence.

220. For a discussion regarding the equivalence of the Japanese's framework in respect of effective supervision and enforcement see paragraphs **1296** to **1398 below**.

IV. Assessment of Japan

221. This section of the report explains how CESR has assessed the equivalence between the Japanese regulatory and supervisory framework and the EU regulatory regime for credit rating agencies.

222. This section is divided as follows:

a) The Japanese legal and supervisory framework;
b) The assessment of the equivalence of that framework to that of the EU.

223. The general differences between the EU and the Japanese approach on implementing a credit rating agency registration and oversight regime are outlined in this Section of this advice.

IV.1 Overall philosophy of approach

224. As a whole, the approach adopted in Japan is very similar to that of the EU Regulation in terms of the legal and supervisory framework that has been established for the oversight of credit rating agencies, and overall there is a philosophy of transparency and pragmatism, both in terms of what the credit ratings agencies have to do in order to be eligible, what they have to disclose and make available to the public, but also in terms of the supervisory approach that has been established in Japan and will be applied to credit rating agencies.

225. Although there are some marked differences, the framework sets out a very large number of prescriptive and comprehensive requirements that cover all the areas of the EU Regulation.

226. The notable differences between the two regimes which are discussed in detail below are:

a) The two tier system that the Japanese have adopted;
b) The differentiation between Japan and non-Japan related credit ratings;
c) The use of Guidelines for the supervision of credit rating agencies;[8]
d) Transparency vis-à-vis the public in respect of documents and records that a credit rating agency is legally obliged to produce and retain; and
e) Treatment of groups of credit rating agencies that allows such groups to leverage off certain processes and procedures that exist at a group level for the purposes of eligibility.

The two tier system that the Japanese have adopted

227. The Japanese have introduced what CESR classifies as a two tier system in relation to the oversight of credit rating agencies and their ratings, through which the entire universe of Japan-related credit ratings are captured.

228. The first tier is a mandatory registration system for all credit rating agencies in relation to all Japan-related credit ratings in order for their credit ratings to be used in Japan for what CESR understands to be regulatory purposes.

8 Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc, (Supplement) Guidelines for Supervision of Credit Rating Agencies ("Guidelines").

229. The second tier is for credit ratings which are not used for regulatory purposes, which if issued by an entity[9] that is not registered as a credit rating agency with the JFSA are supervised through the imposition of additional obligations on the broker dealers[10] vis-à-vis their clients regarding the explanations that they need to give to them when they solicit transactions on financial instruments that have been rated by those non registered agencies.

230. The second tier can also be regarded as a form of promoting voluntary registration, as there is nothing preventing those agencies that choose to issue such ratings from registering with the JFSA.

231. This is discussed in detail in paragraphs **227** above to **268** below.

The differentiation between Japan and non-Japan related ratings

232. The Japanese regulatory and supervisory framework for credit rating agencies differentiates between Japan and non-Japan related ratings.

233. In light of the core objectives of the Financial Instruments and Exchange Act (No 65 of 2008) related to Regulation on Credit Rating Agencies (the "Act"), which are to fully utilize the functions of Japan's capital market and ensure investor protection in Japan, the credit ratings determined at an overseas location by a credit rating agency that is a foreign corporation and which would not be brought into Japan (referred to as "non-Japan related ratings"), will be outside the scope of the Act.

234. This is discussed in paragraphs **316** to **339** below.

The use of Guidelines for the supervision of credit rating agencies

235. CESR considers that in some respects the Japanese regime is more comprehensive than that of the EU Regulation as the Japanese legal and supervisory framework consists of extensive guidelines that as discussed below set out from a practical perspective not only the approach that the supervisors of the regime should apply on a day to day basis, but as they have been consulted upon and published also make it clear for the market at large how the regime is likely in practice to be applied.

236. These Guidelines are discussed in paragraph **273** and paragraphs **340** to **346** below, and CESR makes extensive reference to them throughout the assessment Section IV.2 of this advice.

Transparency vis-à-vis the public in respect of documents and records that a credit rating agency is legally obliged to produce and retain

237. In the Japanese legal and supervisory framework, as part of the overall philosophy of transparency, there are a large number of documents and records that the credit rating agency has to not only create and retain, but also make available for physical inspection for market participants at their premises, as well as in electronic format through the internet.

238. To a certain extent, the list of documents to be disclosed to the public is larger than the one prescribed under the EU Regulation, since it includes for example the procedures to manage confidential information or information on the names of the clients from which the credit rating agency receives a rating fee exceeding 10% of the sales volume of the credit business.

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9 Under the Japanese framework the term credit rating agency is only used for those credit rating agencies registered with the JFSA therefore entity should be understood as being a credit rating agency that is not registered with the JFSA.

10 For the definition of broker dealers as this term is used throughout this advice please see the key of terms to be found at the beginning of this document.

239. The disclosure requirements are discussed in detail in paragraphs **291** to **314** below in this part of the advice and paragraphs **1033** to **1295** of the assessment Section IV.2.

Treatment of groups of credit rating agencies that allows such groups to leverage off certain processes and procedures that exist at a group level for the purposes of eligibility

240. In contrast to the EU Regulation where there is little leeway given in respect of credit rating agencies that form part of large groups, the Japanese have taken a very pragmatic approach to the group structure of credit rating agencies and have introduced provisions through which credit rating agencies registered with the JFSA that form part of the same group and conduct business as a group, can in respect of certain processes and procedures that have to be in place in order to be eligible for registration leverage off what exists at a group level.

241. Namely, credit rating agencies registered with the JFSA and that conduct business as a group are entitled, under certain conditions, (i) to jointly develop an operational control system, (ii) to jointly establish and make public their rating policy, and (iii) to jointly draw up and make public their explanatory documents.

242. This is discussed in paragraphs **431** to **462** and CESR makes reference to this in the assessment Section IV.2 of this advice.

243. In summary the Japanese legal and supervisory framework is characterised by:

- ♦A philosophy of transparency and pragmatism;
- ♦A two tier system that in practice differentiates between the use of credit ratings for regulatory and non regulatory purposes and which captures the use of all credit ratings related to Japan;
- ♦A differentiation between Japan and non-Japan related credit ratings;
- ♦The use of Guidelines for the supervision of credit rating agencies, that act as a guide to both supervisors and the market regarding the approach adopted in Japan for the day to day supervision of credit rating agencies and what is expected in terms of the processes and procedures that a credit rating agency has to have in place in order to be eligible for registration;
- ♦An extensive transparency vis-à-vis the public in respect of the documents and records that the credit rating agency is legally obliged to create and retain; and
- ♦A treatment of groups of credit rating agencies that, differently to the EU, allows such groups to leverage off certain processes and procedures that exist at a group level for the purposes of eligibility.

244. In the EU the philosophy is somewhat different:

- ♦ no differentiation between EU and non-EU related ratings (other than the process through which such ratings can be assessed as eligible for use in Europe);
- ♦ less transparency or extensive use of supervisory guidance;
- ♦ different treatment of groups of credit rating agencies.

IV.2 The Japanese Legal and Regulatory framework for credit rating agencies

Legal framework

245. The Japanese have had a designation system for credit rating agencies for nearly 20 years. Under this system the Commissioner of the JFSA designated certain credit rating agencies as "Designated

Credit Rating Agencies" ("DRAs") in order to enable the ratings that they produced to be used for a number of purposes for example[11]:

a. Credit ratings issued by DRAs are used to estimate market risks and counterparty risks for the purposes of calculating the capital adequacy ratios for securities companies;

b. A security dealer is not allowed to be a lead manager for the security that its parent or subsidiary company issues, however the dealer is exempt from this case where the security is rated by a DRA;

c. In the insurance sector, credit ratings by DRAs are used for calculating the solvency margin ratios regarding estimating credit risks for insurance companies; there is also a restriction on insurance companies investing in assets without designated credit ratings by DRAs and ratings by DRAs are also used for the disclosure requirement for re-insurance contracts;

d. Prospectus eligibility- ratings by DRAs are used as requisites to be disclosed in securities registration statements and prospectuses;

e. Banks Shareholding Purchase Cooperation can purchase – as its special stock purchases scheme, only the stocks of issuers with designated ratings by DRAs;

f. Ratings by DRAs are used as one of the conditions for determining the due dates for submission of modification documents for securitisation planning;

g. Obtaining ratings designated by the Commissioner of the JFSA from DRAs is one of the requirements for issuing (i) specific short term securities, (ii) promissory notes, and (iii) short term investment corporate bonds;

h. Ratings issued by DRAs are also used for determining the due dates for the preparation of investment reports and for exemption from the need to submit such reports.

246. In addition to all of the above, in order for banks and other deposit institutions to be able to calculate their capital adequacy ratios, credit ratings by External Credit Assessment Institutions are used.

247. CESR understands and therefore classifies all of the above uses of the DRA status as "regulatory purposes".

248. There are therefore numerous references to DRAs and their use for regulatory purposes in a number of Cabinet Office Ordinances and Notifications[12].

249. The existing system has as of the 1st April of this year, been changed to **a two tier system**, through legislation that amended the Act, revision of accompanying Cabinet Order and Cabinet Office Ordinances, and the introduction of Guidelines for the supervision of credit rating agencies, which established the legal and supervisory framework for credit rating agencies in Japan.

250. In June 2009, the Japanese "Diet"[13] passed legislation introducing a regulatory framework for credit rating agencies, which was followed by the December 2009 release of Cabinet Orders and Cabinet Office Ordinances laying out the details of the terms and conditions of this framework. The framework, which became effective in April 2010, will require a credit rating agency to be registered with the JFSA in order for its credit ratings to be used for regulatory purposes in Japan and

11 All of these examples are taken from the Joint Forum Stocktaking on the use of credit ratings – June 2009. Please note that the use of credit ratings for regulatory purposes is planned to be reviewed.
12 These are orders made by the Commissioner of the JFSA.
13 This is the term used by the Japanese to describe Parliament.

imposes additional obligations on broker-dealers, effective in October 2010, to provide detailed explanations to customers upon using ratings issued by entities not registered as credit rating agencies with the JFSA.

251. CESR understands that the practical implications of the two tier system is a differentiation between the use of credit ratings for regulatory purposes for which registration of the credit rating agency with the JFSA is a precondition, and credit ratings that are used for non regulatory purposes. Credit ratings issued by entities not registered as credit rating agencies with the JFSA can be used only for non regulatory purposes and there are additional obligations imposed on broker dealers to provide explanations to their clients as discussed in paragraph **250** above.

252. In addition, once a credit rating agency is registered, it is subject to all the provisions of registered status irrespective of whether or not its credit ratings are used for regulatory purposes.

First tier of the new framework - registration under the Act

253. Under the first tier of the new framework, legal entities that actively engage in credit rating business (as defined in Article 2 (35) of the Act) in the Japanese financial markets can register with the JFSA and by doing so become "Credit Rating Agencies" that come under the scope of the new framework.

254. As of the first of April 2010, credit rating agencies could start applying for registered status with the JFSA.

255. The Designated Credit Rating Agency scheme discussed in paragraphs **245** to **248** above will be incorporated into the new credit rating agency registration scheme (by amending the references to DRAs to credit rating agencies in Japanese legislation). As of the time of writing the precise effective date for this incorporation has not yet been determined.

256. The use of "designated" ratings for the regulatory purposes discussed in paragraph **245** above will expire on the 31st December 2010, which means that the necessary amendments to incorporate the old scheme into the new credit rating agency registration scheme will have to be completed by this date.

257. From the 1st of April 2010 up until the time that the old scheme is incorporated into the new scheme, legal entities that actively engage in credit rating business in the Japanese financial markets can continue to issue credit ratings that can be used for regulatory purposes without getting registered, however after that date, credit ratings issued by entities not registered as credit rating agencies with the JFSA will no longer be allowed to be used for regulatory purposes.

258. As an indication of the likely time frame by which legal entities that actively engage in credit rating business in the Japanese financial markets that issue credit ratings that are to be used for regulatory purposes, under Article 328 of Cabinet Office Ordinance on Financial Instruments Business related etc (Ordinance No 52 of 2007) to the Regulation on Credit rating agencies ("COOFIN"), the JFSA has in principle[14] two months to process the application for registered status.

259. Paragraph **276** to **1398** below of this advice explains further details about the first tier of the framework.

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14 Note that the use of the word "in principle" is because of the qualification in Article 328 (1) of the COOFIN which states: "*In cases where any application for registration, authorisation, approval, permission or confirmation listed in any of the following items have been filed, the Commissioner of the Financial Services Agency or other official* ***shall endeavour*** *to render the disposition related to such application within the period set forth respectively in the relevant items, counting from the date of arrival of such application at the relevant office*"

Second tier of the new framework – use of credit ratings produced by entities not registered as credit rating agencies with the JFSA

260. The second tier of the new framework relates to the use of credit ratings produced by entities not registered as credit rating agencies with the JFSA. As the registration system is in essence voluntary if the credit ratings are not to be used for regulatory purposes, credit rating agencies have a choice on whether or not to register if their ratings are not to be used for regulatory purposes.

261. If an entity chooses not to get registered as a credit rating agency with the JFSA, then those that solicit customers to enter into financial contracts involving financial instruments that are rated by that non registered entity, have to abide by new obligations vis-à-vis their clients regarding the explanations that have to be provided to them, that are imposed under the new framework.

262. Under Article 38 of the Act there is a list of prohibited acts that apply to Financial Instruments Business Operators as follows:

"A Financial Instruments Business Operator, etc. or Officers or employees thereof shall not conduct any of the following acts; provided, however, that in the case of the acts listed in items (iv) to (vi) inclusive, those specified by Cabinet Office Ordinance as acts that are not likely to result in insufficient protection of investors, harm the fairness of transactions or cause a loss of confidence in Financial Instruments Business shall be excluded:
(i) - (ii) (omitted)
(iii) an act of soliciting a Contract for a Financial Instruments Transaction by referring to a credit rating (excluding those Credit Ratings specified by Cabinet Office Ordinance as being unlikely to result in insufficient protection of investors) determined by a person engaged in the credit rating business without registration, while not informing said customers of the matters specified by Cabinet Office Ordinance including the fact that the rating is determined by said person who has determined the Credit Rating and has not obtained the registration under Article 66-27 and the matters specified by Cabinet Office Ordinance including the significance of said registration and any other matters, thereby soliciting him/her to conclude a Contract for Financial Instruments Transaction
(iv) – (vii) (omitted)"

263. Under this provision, there is a legal obligation to inform the customers of matters specified in Article 116-3 of COOFIN as follows:

"(i) the significance of a registration under Article 66-27 of the Act;
(ii) the following information regarding the person who has determined the Credit Rating:
(a) the trade name or name;
(b) in cases where the person is a juridical person (including an organization without juridical personality for which the representative person or administrator has been designated), the names of the Officers (in cases of an organization without juridical personality for which the representative person or administrator has been designated, the name of such representative person or administrator); and
(c) the name and location of the head office or any other principal business office or offices.
(iii) an outline of the policies and methods adopted by the person who has determined a Credit Rating in determining such Credit Rating; and
(iv) the assumptions, significance and limitations of the Credit Rating."

264. As can be seen, the requirement regarding the information that has to be provided is quite detailed and covers a number of disclosure points that the EU Regulation requires in relation to ratings is-

sued by registered credit rating agencies as set out and discussed in paragraphs **1033** to **1295** below.

265. Overall the information that needs to be provided is that:

- the rating has been determined by an entity that has not been registered as a credit rating agency with the JFSA;
- information regarding the importance of registered status;
- a summary of the policies and methodology adopted for the determination of such rating; and
- the assumptions, significance and limitations of the credit rating.

266. In the event that this information is not provided, then the JFSA is empowered to take action against those who solicit customers for breach of this requirement accordingly. Details of the type of action that can be taken are provided in Section IV.2.G of this advice from paragraph **1296** onwards.

267. For further information regarding the meaning of "credit ratings that are unlikely to result in insufficient protection of investors" see paragraphs **406** to **409** below.

268. This second tier of the framework will become effective as of the first of October of 2010.

The legal hierarchy of the legal framework for credit rating agencies

269. Having discussed above the two tier system that has been introduced in Japan, CESR sets out below an explanation of the content of this framework and its legal hierarchy.

270. The framework consists of the following measures set out in order to legal hierarchy:

a) The Financial Instruments and Exchange Act (Act No.25 of 1948) related to the Regulation of Credit Ratings Agencies (the "Act");

b) Cabinet Order for Enforcement of the Financial Instruments and Exchange Act (Cabinet Order No.321 of 1965);

c) Cabinet Office Ordinances:

i. Cabinet Office Ordinance on Financial Instruments Business etc (Ordinance No. 52 of 2007 related to the Regulation of Credit Rating Agencies ("COOFIN");
ii. Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act (Ordinance of the Ministry of Finance No.14 of 1993) related to the Regulation of Credit Rating Agencies ("COODEF"); and

d) Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc, (Supplement) Guidelines for Supervision of Credit Rating Agencies ("Guidelines").

271. The Act is the overall high level legal framework, and makes extensive reference to both Cabinet Office Ordinances which add the flesh to the bones of the provisions set out in the Act. These Cabinet Office Ordinances are issued by the Cabinet Office (the JFSA is an external body of the Cabinet Office) and in the Japanese legal hierarchy come a layer under Cabinet Orders issued by the Cabinet (the executive branch of the Japanese government).

272. There are also Cabinet Orders in the Japanese legal framework for credit rating agencies but CESR has not reviewed these as no translation of these has been made available to CESR and the JFSA staff have confirmed that they are of no relevance for the purposes of this equivalence assessment.

273. The Guidelines are not legally binding on credit rating agencies, but serve as a guide to those in the supervision departments who will be supervising credit rating agencies. The Guidelines are very comprehensive and provide a structured overview of the basic approach to the supervision process, evaluation items in supervision and matters that need to be considered, making reference to various aspects of the Act.

274. Unofficial English translations of these texts were published by the JFSA on the 31st March of 2010, and are set out in Annex III of this advice for ease of reference. At the time of writing it is anticipated that the entire version of the translation of the Act will be published later this year.[15]

275. CESR makes extensive reference to all the provisions of the Act, the Cabinet Office Ordinances and the Guidelines in the assessment part of Section IV.2 of this advice, and sets out below a brief explanation of their content.

Content of the Japanese legal and supervisory framework for credit rating agencies

276. The Japanese legal and supervisory framework for credit rating agencies is based on what the JFSA refers to in their answer to question 1 as pillars, of which there are four as follows:

a) The duty of good faith.
b) The obligation to establish operational control systems for the fair and appropriate performance of the credit rating business.
c) Prohibited Acts.
d) Duty to record and disclose information.

a) The Duty of good faith

277. The duty of good faith is set out in Article 66-32 of the Act which states:

"A Credit Rating Agency as well as Officers and employees thereof shall execute their business in good faith and fairly from an independent standpoint."

278. The concept of executing the credit rating business in **good faith** from **an independent standpoint** drives many of the provisions that are set out in the Act, the COOFIN and the Guidelines.

b) The obligation to establish operational control systems for the fair and appropriate performance of the credit rating business

279. Article 66-33 of the Act sets out the legal obligation of the credit rating agency to establish operational control systems as follows:

"(1) A Credit Rating Agency shall establish operational control systems for the fair and appropriate performance of its Credit Rating Business, pursuant to the provisions of Cabinet Office Ordinance in order to conduct its Credit Rating Business with fairness and adequacy.

15 CESR has been advised that the changes will have no impact on this assessment.

(2) The operational control systems referred to in the preceding paragraph shall include measures to maintain the quality of the business such as assigning persons with expert knowledge and skills, measures to prevent the undermining of the investors' interests for the purposes of pursuing its own interest or the interest of a Rating Stakeholders (meaning person specified by Cabinet Office Ordinance as those who have interest with regard to the matters subject to the Credit Ratings; the same shall apply in Article 66-35) and any other measures for ensuring fairness in the business operation."

280. This is what CESR considers to be one of the core elements of the Japanese legal framework, and it drives a large number of provisions set out in the COOFIN, as well as those set out in the Guidelines.

281. The reference in Article 66-33(1) to "Cabinet Office Ordinance" is to Article 306 of the COOFIN which in turn sets out 17 provisions which impose the following obligations on a credit rating agency in relation to the operational control systems that need to be in place. These can be found in the unofficial English translation of the COOFIN which is attached as Annex III of this advice and are also set out in page 3 of the graphical representation of the JFSA's answers set out in Annex IIA of this advice.

282. In light of the number of provisions in Article 306 of the COOFIN, CESR sets out below its understanding in relation to these requirements as follows:

I) measures to enable the credit rating agency to always maintain a fair and unbiased stance in the performance of its credit rating activities (Article 306(1)(i));

II) rotation policy requirements (Article 306(1)(ii)(a)-(b));

III) measures relating to the competence of the individuals that are hired to carry out credit rating activities so that these activities are carried out in a fair manner (see paragraphs **921** to **931 below** for an explanation of the requirements concerning knowledge and experience of people directly involved in credit rating activities) (Article 306(1)(iii));

IV) internal control systems for securing the proper business operation of the credit rating agency have been implemented, including a risk management system (Article 306(1)(iv)(a-c)):
   i. a system to ensure that the executive operates efficiently;
   ii. a system for the preservation and management of the information that the executive used in carrying out its duties;
   iii. regulations and any other systems for the management of risk of loss

V) measures to ensure that the credit rating agency complies with laws and regulations (Article 306(1)(v)(a-c)):
   i. establishment of policies and procedures for the compliance of the credit rating agency with laws and regulations;
   ii. establishment of policies and procedures regarding the selection of the Compliance Officer and the clarification of responsibilities regarding the compliance with laws and regulations;
   iii. establishing measures to deal with situations where employees act illegally (including whistle blowing);

VI) measures related to the establishment and implementation of policies for managing the quality of the processes through which credit ratings are determined (referred to as credit rating determination process) including Article 306(1)(vi)(a-g)):
   i. measures for securing sufficient personnel with the expertise and knowledge to enable them to appropriately and smoothly carry out credit rating business - including how (if there is one) the rating determination committee will operate (for example how it appoints its members, how it makes decisions and measures to ensure that expertise and knowledge can be used in an appropriate manner);

ii. measures to ensure that the information used in determining a credit rating is of sufficient quality;
iii. measures to refrain from determining a credit rating when the credit rating agency is unable to secure sufficient staff with the expert skills and knowledge necessary to determine a credit rating, or where the agency is unable to secure information for the determination of the credit rating that is of sufficient quality;
iv. measures for developing the functions for verifying the appropriateness and effectiveness of the policy to determine credit ratings ("Rating Determination Policy") including measures for securing the proper verification of the rating determination policy for structured finance products when the credit status of any of the underlying assets of the structured finance product changes;
v. measures that are to be implemented when there is any material amendment to the Rating Determination Policy, so that the credit rating agency announces, without delay, the scope of the credit ratings that have already been determined with the former policy but which now require further consideration regarding the need to update the ratings in accordance with the revised policy, the period of time that such updating will take and measures to ensure that such updating takes place within such time;
vi. measures for verifying the ability of the credit rating agency to determine credit ratings in an appropriate manner in relation to a newly designed structured finance product that the credit rating agency has not in the past rated;
vii. measures for verifying and updating existing ratings in an appropriate manner and on an ongoing basis, and where the agency decides not to update and verify the rating, measures to announce this as well as any other necessary information without delay;

VII) measures to prevent conflicts of interest arising in the credit rating business (Article 306(1)(vii)(a-b)):
i. a non exhaustive list of measures (with five examples of them) to identify, credit rating activities that entail any actual or potential conflicts of interest ("Specified Acts"), and to secure that such acts would not adversely affect the interest of investors (referred to as "measures for preventing conflicts of interest);
ii. measures to publish the actual or potential conflicts of interest and an outline of the measures for preventing them;

VIII) measures so that activities pertaining to ancillary business or other lines of business would not unreasonably affect the credit rating activities (Article 306(1)(viii));

IX) measures (three of them) to enable an independent third party to verify the appropriateness of credit ratings issued by the credit rating agency in relation to structured finance products (Article 306(1)(ix));

X) measures relating to the credit rating agencies remuneration policy for the chief compliance officer, the rating analysts and the members of the rating committee , and the periodical review of the policy. The policy has to satisfy a number of criteria (two of them), and ensure that the remuneration policy does not adversely affect the fair and adequate execution of the credit rating business (Article 306(1)(x));

XI) measures to prevent those in charge of determining a credit rating from participating in the negotiation of the fee for the credit rating (Article 306(1)(xi));

XII) measures (two of them) for the proper management of confidential information and the maintenance of the confidentiality of the information (Article 306(1)(xii));

XIII) measures to appropriately and swiftly address complaints raised against the credit rating agency including establishing a system for reporting such complaints to officers (Article 306(1)(xiii));

XIV) measures so that the credit rating agency carries out its credit rating business in accordance with its rating policy, including measures pertaining to the training of rating analysts (Article 306(1)(xiv));

XV) measures to prevent the false representation of the general features of the results of the assessment of the credit status of any financial instruments or legal persons, or to prevent

any representation which may lead to any misperception of any material information (Article 306(1)(xv));

XVI) measures to prevent ancillary services conducted by the credit rating agency being construed as being services that relate to the credit rating agency's credit rating business (Article 306(1)(xvi));

XVII) measures for the establishment of the Supervisory Committee that has to meet 5 requirements for details of this see paragraphs **503** to **505** below (Article 306(1)(xvii)).

283. Further details regarding what is expected in relation the operational control requirements set out in paragraph **282** II-XVII above are set out in Section III-2-1(1)-(16) of the Guidelines, to which reference is made in the assessment Section IV.2 of this advice.

284. In addition to the above, Articles 307 and 309 of the COOFIN set out additional explanations regarding the meaning of Rating Stakeholders, and Matters in which they have an interest to which reference is made in the provision setting out the measures to prevent conflicts of interests in Article 306(1)(vii) of the COOFIN discussed in paragraph **563** to **569** below.

285. These operation control requirements are discussed in detail throughout the assessment Section IV.2 of this advice.

c) Prohibited Acts

286. Article 66-35 of the Act sets out the third pillar of the Japanese legal and supervisory framework for credit rating agencies - namely the prohibition for a credit rating agency and its officers or employees to carry out any of the following three acts (referred to as "prohibited acts") with regard to the credit rating activities:

a) the provision of a credit rating where there is some form of close relationship between the credit rating agency or its officers or employees and the rated entity (Rating Stakeholder) with some form of interest in the rating that is being given (Article 66-35(i)):

"(i) in cases where the Credit Rating Agency or the Officers or employees thereof have a close relationship specified by Cabinet Office Ordinance with a Rating Stakeholder, an act of providing to someone or making available to the public, Credit Ratings on matters specified by Cabinet Office Ordinance as those in which the said rating stakeholders has interests"

b) the provision of advice in relation to certain matters that may have a material influence on the credit rating of the Rating Stakeholder, by the credit rating agency or its officers or employees to the Rating Stakeholder (Article 66-35(ii));

"(ii) in cases where the Credit Rating Agency or the Officers or employees thereof have given advice to a rating stakeholder on matters specified by Cabinet Office Ordinance as those that may have material influence on the Credit Rating related to the said Rating Stakeholder (excluding cases where the Credit Rating Agency or the Officers or employees thereof have provided the details of the Rating Policy, etc. as defined in paragraph (1) of the following Article in response to the request from the said rating stakeholder or other cases specified by Cabinet Office Ordinance as being less likely to result in insufficient protection of investors in light of the manner of advice), an act of providing to someone or making available to the public the said Credit Ratings;" and

c) acts set out in the "*Cabinet Office Ordinance*" the provision of which results in the insufficient protection of investors or causes a loss of confidence in the credit rating business (Article 66-35(iii)):

"(iii) in addition to what is listed in the preceding two items, acts specified by Cabinet Office Ordinance as those resulting in insufficient protection of investors or causing a loss of confidence in Credit Rating Business."

287. As stated in the aforesaid provisions, COOFIN sets out further details in relation to the meaning of the actions covered by these prohibitions as follows:

a) In relation to the prohibition set out in paragraph **286 a)** above of providing a credit rating where there is some form of close relationship with the Rating Stakeholder with some form of interest in the rating that is being given, Article 308 of the COOFIN sets out the situations that give rise to the close relationship, and Article 309 of the COOFIN sets out the interests in question;

b) In relation to the prohibition set out in paragraph **286 b)** above, of the provision of advice in relation to certain matters that may have a material influence on the credit rating, Article 310 of the COOFIN sets out what these matters are, and Article 311 of the COOFIN sets out what advice can be provided which does not fall within the prohibition;

c) In relation to the third prohibition set out in paragraph **286 c)** above, of the acts set out in Cabinet Office Ordinances that result in the insufficient protection of investors or that cause a loss of confidence in the credit rating business, Article 312 of the COOFIN sets out the three acts in question.

288. In addition to these prohibition, Article 66-34 of the Act sets out an additional prohibition relating to the use of the name of the credit rating agency as follows:

"A Credit Rating Agency shall not have another person engage in Credit Rating Business under the name of said Credit Rating Agency".

289. Section III -2-2 of the Guidelines also adds further details in relation to these prohibitions.

290. These prohibitions are discussed in detail in paragraphs **600** et seq. below.

d) Duty to record and disclose information

291. The final pillar of the Japanese legal and supervisory framework in relation to credit rating agencies is the duty to record and disclose information.

292. The requirements in relation to record keeping and disclosure are divided into the following three broad areas:

a) Requirements relating to timely disclosure;

b) Requirements relating to periodic disclosure; and

c) Record keeping and other disclosure requirements.

a) Requirements relating to timely disclosure

293. Article 66-36 of the Act sets out the obligation on a credit rating agency to establish and publish policies and methods for determining credit ratings and also for providing credit ratings to someone or making them available to the public as follows:

"(1) A Credit Rating Agency shall, pursuant to the provisions of Cabinet Office Ordinance, establish the policies and methods for determining and also either providing to someone or making available to the public the Credit Ratings (such policies shall collectively be referred to as the "Rating Policy, etc." in the following paragraph) and publish the said Rating Policy, etc. The same shall apply when the Credit Rating Agency has changed the Rating Policy, etc.
(2) A Credit Rating Agency shall conduct its Credit Rating Business in accordance with its Rating Policy, etc."

294. These policies have to meet the requirements set out in Article 313 of the COOFIN, and have to be published in accordance with the requirements set out in Article 314 of the COOFIN.

295. The requirements set out in Article 313 of the COOFIN are very comprehensive and are further divided into two broad sets of requirements:

a) requirements relating to the rating determination policy; and
b) requirements relating to the rating provision policy.

Requirements relating to the rating determination policy

296. The rating determination policy is the ensemble of methodologies and procedures used by a credit rating agency to determine credit ratings, and Article 313 (2) of the COOFIN sets out a number of requirements in relation to the rating determination policy which CESR understands to be the following:

I) that the methodologies need to be rigorous and systematic;
II) that it requires that any and all information collected regarding the credit status of the financial instrument and entity being rated is taken into account;
III) that it covers, on a product by product basis assumptions, rating categories[16], and an outline of the methodology used on a rating by rating basis;
IV) that it provides for policies and methods that enable a Rating Stakeholder to verify the accuracy of the information used by the credit rating agency in determining the credit rating and to express its opinion, prior to providing or making available the credit rating to the public; and
V) that it provides for the policies and methods for determining unsolicited credit ratings.

297. Article 314 of COOFIN sets out additional details in relation to how the rating determination policy is to be published.

298. These requirements are discussed in detail in paragraphs **864** et seq. below.

Requirements relating to the ratings provision policy

299. The ratings provision policy relates to how the credit ratings are provided or made available to the public. The requirements of this policy are very comprehensive and are set out in Article 313 (3) of the COOFIN. CESR understands the requirements that this policy has to satisfy to be the following:

16 Rating categories - means the criteria used for setting the grades indicating the results of the assessment of credit status.

I) that the determined credit ratings are provided or made available to the public without delay;
II) that the determined credit ratings that are made public are targeted to the public at large;
III) requirements (eleven of them) relating to the content of credit ratings that are to be made public, including specific requirements relating to structured finance products, and requirements specifying that the credit rating is to be made available on the internet or through other means;
IV) that information relating to the withdrawal of a determined credit rating is provided without delay; and
V) that it does not make indications that have the potential to cause misunderstanding that the Commissioner of the JFSA or other administrative bodies have guaranteed the validity of the results of a credit assessment.

300. Section III-2-3 of the Guidelines sets out further details of what the rating determination and the rating provision policies need to provide for.

301. All these requirements are discussed in detail in paragraphs **868** to **1165** below.

b) requirements relating to periodic disclosure

302. The Japanese legal and supervisory framework sets out detailed and comprehensive requirements relating to the periodic disclosure that credit rating agencies are required to make.

303. Article 66-39 of the Act imposes an obligation on a credit rating agency to prepare each year certain explanatory documents relating to its business operations as follows:

> *"…for each business year, prepare explanatory documents containing the matters specified by Cabinet Office Ordinance as the matters concerning status of business, and keep the said explanatory documents at all of its business offices or offices and make them available for public inspection, as well as publicizing them via the Internet or by any other method pursuant to the provisions of Cabinet Office Ordinance, for one year from the day on which the period specified by Cabinet Order has elapsed after the end of each business year."*

304. Article 318 of the COOFIN sets out further requirements in relation to these explanatory documents, which CESR understands to be the following:

I) matters related to the overview of the credit rating agency's profile and its organisation, setting out detailed requirements of what needs to be included;
II) matters related to the status of the credit rating agencies business, setting out detailed requirements of what needs to be included;
III) the status of the development of the operational control systems including an outline of a number of matters;
IV) an outline of the credit rating policies; and
V) information relating to the status of the credit rating agency's affiliates and subsidiaries, setting out detailed requirements of what needs to be included.

305. Article 319 of the COOFIN sets out requirements relating to how these documents and records need to be made available for public inspection and published on the internet.

306. All these requirements are discussed in detail in paragraphs **1033** et seq. below.

c) Record keeping and other Disclosure requirements

307. Articles 66-37 and 66-38 of the Act set out the obligations on a credit rating agency in relation to record keeping and other disclosure requirements.

308. Article 66-37 of the Act requires that the credit rating agency:

"…pursuant to the provisions of Cabinet Office Ordinance, prepare and preserve the books and documents related to its Credit Rating Business."

309. Article 315 of the COOFIN sets out the details of what books and documents in relation to the credit rating agency's credit rating business need to be prepared and kept for a period of five years which CESR understands to be the following:

I) records relating to credit ratings that the credit rating agency has determined, specifying what the content of these records need to be;
II) records relating to Rating Stakeholders that have paid a fee for credit ratings specifying what the content of these records need to be;
III) documents describing the services and products that the credit rating agency provided;
IV) documents regarding credit assessments that served the basis of the credit determination policy;
V) documents describing the results of the status of the credit rating agency's compliance with laws and regulations;
VI) documents describing the Specified Acts and measures for avoiding conflicts of interest;
VII) minutes of the Supervisory Committee's meetings;
VIII) records regarding the progress of important negotiations between executives or employees and Rating Stakeholders relating to credit rating activities;
IX) documents and electronic records received from investors and any other users of ratings relating to complaints regarding credit rating activities; and
X) ledgers.

310. In addition to the above, Section III-3-4 of the Guidelines sets out further details in relation to these document and records.

311. The record keeping requirements are discussed in paragraphs **845** to **853** below.

312. Article 66-38 of the Act requires that a credit rating agency submit yearly a business report to the JFSA:

"pursuant to the provisions of Cabinet Office Ordinance, prepare a business report for each business year, and submit it to the Prime Minister[17] within the period specified by Cabinet Order after the end of each business year."

313. The details of what needs to be provided is set out in Article 316 of COOFIN as follows:

"(1) A business report to be submitted by a Credit Rating Agency pursuant to the provision of Article 66-38 of the Act shall be prepared in accordance with Appended Form No. 28.
(2) When a Credit Rating Agency prepares a business report as set forth in the preceding paragraph, it shall be subject to corporate accounting standards generally accepted as fair and appropriate."

314. These requirements are discussed in paragraphs **1243** to **1250** below.

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17 Note that when reading the provisions of the Act in this advice a reference to "Prime Minister" should be read as a reference to the Commissioner of the JFSA as set out in Article 194-7 of the Act.

315. Overall, as can be seen, the four pillars of the Japanese legal and supervisory framework for credit rating agencies are very comprehensive, and as discussed in the assessment section of this advice, cover all of the requirements set out in the EU Regulation.

Japan and non-Japan related ratings

316. As mentioned in paragraphs **245** et seq. above, the Japanese regulatory and supervisory framework for credit rating agencies differentiates between Japan and non-Japan related ratings.

317. It is CESR's understanding, which is reinforced by the Guidelines, that in light of the extensive use of credit ratings in the financial capital markets as a reference for investors to evaluate credit risk when making investment decisions, the Act is designed to enable the full use of the Japanese capital market and to protect investors.

318. In view of this, the JFSA decided to exclude from the scope of the regulatory and supervisory framework for credit rating agencies, those credit ratings determined at an overseas location by a credit rating agency that is a foreign corporation and which could be but are not expected to be brought into Japan, as the core objective of the regime is to cover credit ratings that are to be used in the Japanese market.

319. This means that those credit ratings that are classifiable as "non-Japan related ratings" do not need to meet the requirements discussed above that apply to Japan related ratings that are within the scope of the Japanese regime.

320. This differentiation between Japan and non-Japan related ratings is something that needs to be verified by a credit rating agency that is a foreign corporation on a rating by rating basis, and as such is something that happens after the registration process.

321. To be classifiable as a non-Japan related credit rating, the credit rating determined at an overseas location by a credit rating agency that is a foreign corporation has to satisfy the following criteria as set out in Section III-2-1 (4)(iii)(c) of the Guidelines:

- that the rating is not a credit rating of a financial instrument that "*is premised on solicitation by financial instruments business operators, etc in Japan*";
- that the Rating Stakeholder is not domiciled in Japan; and
- in respect of structured finance products, the major[18] underlying asset of the product is not located in Japan.

322. As an example of what a non-Japan related rating is in practice, this would be a US credit rating agency issuing credit ratings from a US office about a US corporate bond which is solely sold to US investors. Such ratings are outside of the scope of the regime, as they do not relate to the Japanese market.

323. It is up to each credit rating agency that is a foreign corporation to determine whether or not the use of its credit ratings determined at an overseas location falls within any of the three criteria. Section III-2-1(4)(iii) (development of operational control systems to identify credit ratings that are subject to the Act) of the Guidelines sets out that from the perspective of developing the operational control systems for ensuring that a credit rating agency which is a foreign corporation meets its legal obligations, it is necessary for such a foreign credit rating agency to clarify which of its credit rating activities are subject to the Act.

18 The meaning of "major" in this context is something that the credit rating agency has to determine.

324. The Guidelines explain that when the supervisory departments are examining these credit rating agencies, they have to take a number of points into consideration:

"(a) Whether the credit rating agency, taking into account the nature of its own business, has established in advance specific procedures for identifying the scope of credit ratings that are subject to the Act. Also, whether the credit rating agency, in accordance with these procedures, appropriately specifies and clarifies which of the credit ratings it determines are subject to the Act.
(b) Whether the credit rating agency periodically examines the validity of the specified scope of credit ratings that are subject to the Act, and makes revisions as necessary.
(c) Whether the credit rating agency has clearly stated in its rating policy, etc. (the policies and methods for determining and providing credit ratings, or for making them available for inspection; the same shall apply hereinafter) which of the credit ratings it determines are subject to the Act."

325. As such, as part of the application process, a credit rating agency which is a foreign corporation has to make it clear which aspects of the credit rating activities need to comply with the Japanese legal and supervisory requirements for credit rating agencies.

326. The problem is that in practice a credit rating agency has no control over what is done with the rating that it produces, and as such the distinction between Japan and non-Japan related ratings is primarily targeted to the primary market where there is a greater correlation between the performance of the financial instrument and its credit rating.

327. If a credit rating agency which is a foreign corporation is in a position to know that its credit ratings will be made use of in Japan, then the agency is expected to take this into account when developing the necessary processes that it has to have in place in order to be able to comply with the Japanese legal and regulatory framework.

328. All credit ratings that are not classifiable as non-Japan related ratings come within the scope of the framework and the provisions discussed above will apply to all registered credit rating agencies regardless of location.

329. The Guidelines reinforce this by making it clear that credit ratings that are determined by a foreign corporation if determined in Japan will not be classifiable as a non-Japan related rating, and provisions of the framework will apply to it.

330. The Japanese legal and supervisory framework for credit rating agencies therefore requires that credit ratings that are issued outside of Japan and are to be used in Japan have to be issued by a credit rating agency that is registered in Japan, and that in order to be registered, the agency has to have a physical presence (business office or office) in Japan.

331. In addition, CESR points out that offices of credit rating agencies that issue credit ratings outside of Japan but which are used in Japan do come within the scope of the regime.

332. There are however a number of exemptions that can be applied in respect of foreign credit rating agencies that are part of group, as discussed in paragraphs **431** et seq. below.

Equivalence of third country regimes in the future

333. In addition to the distinction between Japan and non-Japan related ratings, the Japanese could also in the future have a similar system in place to that of the EU in respect of credit ratings that are issued outside of Japan where there is no form of physical presence in Japan, but where such credit ratings can be used if the credit rating agency is considered to be subject to equivalent supervision in the third country.

334. Article 66-30(2) of the Act provides that the Commissioner of the JFSA must refuse registration where the applicant is a foreign legal person and does not have a business office or an establishment in Japan, unless the applicant is considered to be subject to appropriate supervision by the administrative agency in the foreign jurisdiction that is "deemed to correspond" to how such entities are supervised in Japan. In the latter case, the credit rating agency needs to designate a representative person in Japan to act as a liaison coordinator with the Commissioner of the JFSA.

335. The specific provisions that will apply for assessing equivalence will be set out in Cabinet Office Ordinances, which will specify the conditions under which the protection of Japanese investors and the effectiveness of inspection and supervision can be ensured without the need for the credit rating agency to establish a physical presence in Japan.

336. Examples of some of the considerations that may be taken into account are the equivalence of the third country's supervisory framework for credit rating agencies, and the ability of the third country authority to cooperate from a supervisory perspective with the JFSA.

337. Although this is something for the future, CESR points out it hopes that this advice may serve as a useful reference point when the equivalence of the EU regime is assessed by the Japanese against the Japanese regime.

338. CESR also points out that the cooperation arrangements that have to be in place with Japan in order to enable the certification and endorsement of credit ratings issued from Japan to be used in Europe, will also facilitate the speed at which EU ratings could be used in Japan without the need for a physical presence in Japan.

339. The requirements for certification and endorsement are set out in paragraphs **12** to **21** above.

Guidelines

340. The Guidelines are as explained above not legally binding but they act as a guide to the supervision department and are very comprehensive.

341. The Guidelines serve as a very useful explanation of some of the basic concepts that apply to the way in which the supervision of credit rating agencies is going to take place in Japan and what the credit rating agencies can expect in terms of what they will need to comply with. Therefore they serve to explain not only that requirements that need to be complied with in order to be able to be eligible for registration in the first place, but also on an ongoing basis what credit rating agencies will be expected to have to demonstrate, failing which their supervisors could for example ask them to make improvements to their business operations.

342. These Guidelines replace what was in the past referred to as "Administrative Guidelines", and as such can also be seen as guidelines for credit rating agencies in terms of how the legal requirements should in practice be implemented, setting out in detail what they are required to do and the processes and procedures that they need to have in place.

343. As set out in Section I-2 of the Guidelines, the JFSA considers it essential that:

"financial authorities properly motivate credit rating agencies to enhance internal control systems that are attentive to, inter alia, the protection of investors".

344. The Guidelines go on to explain that:

"For this reason, for the purpose of conducting routine supervision of credit rating agencies, it was decided to prepare an approach to supervisions, points of focus and attention when conducting supervision, and specific supervisory techniques.

345. In addition, the Guidelines explain that supervision requires a flexible approach, taking into account the size and state of the credit rating agencies that are being supervised as follows:

"These Guidelines were compiled with due consideration of the actual state of credit rating agencies so that they could be applied to various cases, and as such, not all supervisory evaluation points contained in these Guidelines should be uniformly applied to all credit rating agencies.

Accordingly, when applying these Guidelines, it is necessary to bear in mind that, even if a credit rating agency does not meet the requirements of individual evaluation points word for word, the case shall not be judged inappropriate insofar as there is no problem from the viewpoint of protecting public interests and investors. That is, care needs to be taken to avoid applying the Guidelines in a mechanical and uniform fashion. On the other hand, it should also be remembered that, even if a credit rating agency formally possesses all the functions relating to the evaluation points, in some instances, the case could be deemed to be inappropriate from the viewpoint of protecting public interests and investors."

346. The Guidelines then set out a number of details in respect of many of the requirements set out in the Act and the Cabinet Office Ordinances, as well as some notes which add additional clarification.

Application process

347. The Japanese framework sets out through the Act and Cabinet Office Ordnances detailed and prescriptive requirements, clarified by the Guidelines in relation to how credit rating agencies apply for registered status in Japan.

Registration

348. The general provision to register with the JFSA is set out in Article 66-27 of the Act.

349. The contents of the information that needs to be provided is set out in Article 66-28 of the Act:

"A person who intends to obtain the registration set forth in the preceding Article shall submit a written application for registration containing the following matters to the Prime Minister. In this case, a foreign juridical person shall designate a representative person in Japan (limited to an individual who takes charge of business operations at all business offices or offices that said foreign juridical person establishes in Japan so as to engage in Credit Rating Business) or a person specified by Cabinet Office Ordinance as being equivalent thereto and submit said written application for registration:
(i) trade name or name;
(ii) name(s) of the Officer(s) (including the representative person or administrator of an organization without judicial personality for which a representative person or administrator has been designated; hereinafter the same shall apply in this Chapter);

(iii) name and location of the business office or office for Credit Rating Business (the head office, principal business office or office or any other business office or office in Japan, for a foreign juridical person);
(iv) the type of the person's other business (es), if any; and
(v) other matters specified by Cabinet Office Ordinance.
(2) The following documents shall be attached to the written application for registration set forth in the preceding paragraph:
(i) a document to pledge that the person does not fall under Article 66-30, paragraph (1), item (ii) or (iii);
(ii) a document that contains the matters specified by Cabinet Office Ordinance as the contents and methods of Credit Rating Business;
(iii) articles of incorporation and certificate of registered matters of the company (including documents equivalent thereto); and
(iv) other documents specified by Cabinet Office Ordinance.
(3) In the case referred to in item (iii) of the preceding paragraph, when the articles of incorporation are prepared in the form of an Electromagnetic Record, such Electromagnetic Record (limited to that specified by Cabinet Office Ordinance) may be attached in lieu of documents. "

350. The additional requirements relating to "other matters" to which reference is made in paragraph (1)(v) of the above Article, are very detailed and are set out in Article 298 of the COOFIN.

351. The additional requirements relating to the information that needs to be provided in respect of "contents and methods of Business" to which reference is made in paragraph 2(ii) of the Article above are set out in Article 299 of the COOFIN, and the other documents to which reference is made in paragraph 2(iv) of the Article 66-28 above are set out in Article 300 of the COOFIN.

352. Additional clarification and details in relation to these requirements is set out in Section III-3-1 of the Guidelines, and from discussion with the staff of the JFSA CESR points out that the Guidelines act as check points to ensure that the applicant meets all the necessary requirements for registration to be granted, failing which the credit rating agency will not be able to proceed with the application.

353. The requirement to fill in an application form is set out in Article 296 of the COOFIN, with the application form itself set out in Appendix 27.

354. As can be seen, under Article 66 -28(1) of the Act in the event that the credit rating agency is a "foreign juridical person" it needs to designate either a representative in Japan (in case of foreign credit rating agency with physical presence in Japan) or an equivalent person (in cases where the foreign credit rating does not have a physical presence in Japan) and to submit the application form.

355. A representative person is defined in Article 66-28(1) of the Act as:

"an individual who takes charge of business operations at all business offices or offices that said foreign juridical person establishes in Japan so as to engage in credit rating business."

356. A person equivalent to a representative person is defined in Article 297 of the COOFIN as follows:

"A person as specified by Cabinet Office Ordinance, as referred to in Article 66-28, paragraph (1) of the Act, shall be a person who, as a representative of a foreign juridical person (limited to a foreign juridical person which, pursuant to the provision of Article 66-30, paragraph (2) of the Act, is not required to have its business office or any

other office in Japan), acts as a liaison and coordinator with the Commissioner of the Financial Services Agency (limited to a person who is capable of providing an account of the status of its Compliance With Laws and Regulations, etc.)"

Processing the application

357. The JFSA has in principle two months to process the application as set out in Article 328 of the COOFIN.

Grounds for rejecting the application

358. The grounds for rejecting the application for registration are set out in Article 66-30 of the Act and these are:

"(1) The Prime Minister shall refuse registration when an applicant falls under any of the following items, or when a written application for registration or documents or Electromagnetic Records to be attached thereto contain fake statements or records, or lack statements or records about important matters:
(i) a person other than a juridical person;
(ii) a juridical person who falls under Article 29-4, paragraph (1), sub-item (a) or (b);
(iii) a juridical person who has a person falling under any of sub-items (a) to (g) inclusive of Article 29-4, paragraph (2), item (ii) among its Officers;
(iv) a juridical person whose other business is found to be against the public interest; or
(v) a juridical person who is found not to have established a system necessary for the fair and appropriate performance of the Credit Rating Business.
(2) The Prime Minister shall, in addition to what is provided for in the preceding paragraph, refuse the registration when the applicant for registration has no business office or office in Japan in cases where the applicant for registration is a foreign juridical person; however, this shall not apply in cases specified by Cabinet Office Ordinance as such where the relevant applicant for registration is deemed to be subject to appropriate supervision of an administrative agency in foreign jurisdiction which supervises the person who conducts business deemed to correspond to Credit Rating Business, or any other organization equivalent to such agency, or in cases where the refusal of registration under the main clause of this paragraph shall preclude sincere implementation of treaties or any other international agreement."

359. The test in relation to the ground referred to in Article 66-30(1)(v) of the Act above – relating to where a judicial person is found not to have established a system necessary for the fair and appropriate performance of the Credit Rating Business - is set out in Article 303 of the COOFIN and Section III-3-1 (4) of the Guidelines.

360. The procedure to refuse registration is further explained in Section III-3-1 (7) of the Guidelines.

361. Further details of a representative of a foreign juridical person are stipulated in Article 297 of the COOFIN.

Publication of aspects of the application

362. Following the filing of the application, the JFSA registers certain aspects of the application with the registry of credit rating agencies as set out in Article 66-29 of the Act:

"When an application for registration set forth in Article 66-27 has been filed, the Prime Minister shall register the following matters in a registry of Credit Rating Agencies,

except when he/she refuses the registration under the provisions of the following Article:
(i) the matters listed in the items of paragraph (1) of the preceding Article; and
(ii) the date of registration and registration number.
(2) The Prime Minister shall make the registry of Credit Rating Agencies available for public inspection."

363. As can be seen, some of the information provided as part of the application process are made public, and Article 302 of the COOFIN clarifies that public inspection can be done at the JFSA.

Measures that can be taken in respect of the registration process

364. Articles 198(ii) and 207(1)(vi) of the Act set out the measures that can be taken in the event that the registration is obtained by wrongful means, in which case this can be punished by imprisonment and/or a fine of not more than 3 million yen on the offender and a fine of 3 million yen on the credit rating agency.

365. In addition, imprisonment with work for no more than 1 year and/or a fine up to 3 million yen can be imposed where a person has entered a fake statement or record into written application for registration as a credit rating agency or documents to be attached thereto or electromagnetic records.[19] In the same case, a fine up to 200 million yen can be imposed on the credit rating agency.

Notification of changes to the information provided in applying for registration

366. Article 66-31 of the Act imposes obligations on the credit rating agency in the event that any changes are made to the information that has been provided as part of the application process.

367. These have to be notified at different times and to different recipients depending on whether the information that is changed relates to those aspects that were required to be made public in the first place, or not.

368. Changes to the information that needs to be provided as set out in Article 66-28(1) of the Act that were made public have to be notified within 2 weeks of the date of change, and this information gets updated in the registry of credit rating agencies, and the change is therefore made public.

369. Changes to the documents that are required to be provided in accordance with Article 66-28(2) of the Act have to be made without delay and are notifiable only to the JFSA.

370. Additional details of these requirements are set out in Article 304 of the COOFIN.

Measures that can be taken for not notifying changes

371. In the event that the credit rating agency fails to make these notifications, Article 205-2-3 of the Act sets out that a financial penalty on the offenders of not more than 300 thousand yen can be imposed.

372. Pursuant to Article 207 of the Act, an additional fine of 300 thousand yen will be imposed on the credit rating agency.

19 Article 198-6(i) of the Act relating to violations of Article 66-28 of the Act.

373. In the event that the change in registration as a result of this notification is obtained by wrongful means, Article 198 of the Act sets out that this can be punished by imprisonment and/or a fine of not more than 3 million yen.

Regulatory framework once credit rating agencies are registered

374. After registration, a credit rating agency becomes subject to all the requirements governing the activities of credit rating agencies in the Japanese legal and regulatory framework (except in certain cases where exemptions apply) and subject to supervision and enforcement.

Organisational design of the JFSA in respect of the oversight of credit rating agencies

375. Oversight of credit rating agencies in the JFSA is carried out in a number of different divisions depending on the nature of what is being done as described in paragraphs **1302** to **1320** below.

376. The JFSA has extensive supervisory powers discussed in detail in paragraphs **1328** to **1376** below and as set out briefly below.

377. The Act sets out the detailed requirements in relation to the supervision of credit rating agencies.

378. The JFSA has a broad range of powers, and in relation to the supervision of credit rating agencies, the Act sets out the following obligations and measures that can be taken in respect of non compliance of a credit rating agency with its legal obligations:

I) order to improve the business operations as set out in Article 66-41;
II) rescission of registration, or suspension of all or part of the credit rating agencies business by the JFSA if the credit rating agency falls under one of the grounds set out in Article 66-42;
III) notification to the public of the Rescission or suspension of the credit rating agencies business in accordance with Article 66-42, as set out in Article 66-43;
IV) order the credit rating agency and various others who conduct business with the credit rating agency or have been entrusted with receiving business from it, to produce reports and materials that will be helpful for the understanding the business of the credit rating agency, or inspection of the status of the business, documents and other articles of the credit rating agency as set out in Article 66-45; and
V) penalties that apply for breaches of certain requirements, which may include imprisonment and/or the imposition of financial penalties.

379. The COOFIN and the Guidelines also include practices of the JFSA and details of the provisions that deal with the supervisory and enforcement powers set out under the Act.

380. Further details of this are set out in paragraphs **1296** to **1398** below.

Box 1

THE JAPANESE LEGAL AND REGULATORY FRAMEWORK FOR CREDIT RATING AGENCIES

381. Japan has a very comprehensive and legally binding framework in relation to credit rating agencies and the use of credit ratings. A registration system was introduced on the 1st of April 2010 and it is intended to replace the existing designation system for credit rating agencies which Japan has had for nearly 20 years and will expire by the 31st of December 2010.

382. Under the new system, Japan operates a two-tier regime as discussed in paragraphs 249 to 268.

383. The first tier relates to registration of credit rating agencies with the JFSA. Credit rating agencies have to register with the JFSA if they want to enable their ratings to be used for regulatory purposes by the cut-off date of the existing designated rating agencies regime.

384. The second tier, which will become effective as of October 2010, provides for additional obligations on the broker dealers vis-à-vis their clients regarding the explanations that they need to give to them when they solicit transactions on financial instruments that have been rated by those entities that are not registered as credit rating agencies with the JFSA.

385. The hierarchy of the legal framework for the credit rating agencies in Japan consists of the Financial Instruments and Exchange Act (the "Act"), two Cabinet Office Ordinances, and comprehensive Guidelines for the Supervision of Credit Rating Agencies (the "Guidelines"). The combined result of this different but inextricably linked set of provisions makes for a detailed but pragmatic approach to the imposition of obligations on credit rating agencies and their supervision on an on-going basis. This is further discussed in paragraphs 269 to 275 above and paragraphs 340 to 346 above.

386. CESR points out that there are some differences between the EU and the Japanese approach regarding the types of framework that have been put in place for the purposes of regulating and supervising credit rating agencies, but the system that has been put in place in Japan is very similar to that of the EU.

387. Overall, it is clear that both the EU and Japan share the same overall objectives namely, to ensure that credit rating activities are carried out fairly from an independent standpoint.

388. The Japanese approach is based on four pillars, as explained in paragraphs 276 to 315 above. Namely, the Japanese regime is based on: (i) the duty of good faith; (ii) the obligation of a credit rating agency to establish operational control systems for the fair and appropriate performance of the credit rating business through a large number of detailed and prescriptive requirements; (iii) extensive provisions in relation to avoidance, management and disclosure of conflicts of interests, and (iv) the duty to record and disclose information both to the JFSA and/or the public.

389. The JFSA is prohibited by the COOFIN from influencing the substance of credit ratings and credit rating methodologies.

390. **The framework differentiates between Japan-related and non-Japan related ratings, as discussed in paragraphs 316 to 332 above.**

391. **The Japanese may introduce a system of equivalence of non-Japanese (foreign) credit rating agencies as discussed in paragraphs 333 to 338 above.**

IV.3 The Assessment

392. Having explained the overall legal framework of the existing regulatory regime in Japan, the objective of this chapter is to assess whether credit rating agencies authorised or registered in Japan comply with legally binding requirements which are equivalent to the requirements resulting from the EU Regulation and whether they are subject to effective supervision and enforcement in Japan.

393. As explained in paragraph **70** above, in determining the overall equivalence of the Japanese regulatory and supervisory framework to that of the EU regime, the overall objective is to assess whether or not the framework overall enables assurance that:

"users of ratings in the EU would benefit from equivalent protections in terms of CRAs' integrity, transparency, good governance and reliability of the credit rating activities."

394. In order to establish whether or not the Japanese framework achieves this objective, (as explained in paragraph **72** above, CESR divided the EU Regulation into different sections, and established for each of them what the conditions are that need to be in place assessing equivalence and the objectives that need to be met in order for equivalence to be said to be in place.

395. In discussing the equivalence of the Japanese regime for ease of reference, this section is divided into the same order as set out in Section II as follows:

a. Scope of the Japanese regulatory and supervisory framework;
b. Corporate governance;
c. Conflicts of interest management;
d. Organisational requirements
e. Quality of methodologies and ratings
f. Disclosure
g. Effective supervision and enforcement

A. Scope of the Japanese regulatory and supervisory framework

396. In establishing the equivalence of the scope of the Japanese regulatory and supervisory framework, as explained in paragraph **77** above, the following needs to assessed:

a. the legal definition of what a credit rating agency is and the activities a registered credit rating agency can conduct are;
b. the exemptions that can be granted; and
c. whether or not the authority in question is prohibited from influencing the content of ratings and methodologies.

a) the Japanese legal definition of what a credit rating agency is and the activities that a registered CRA can conduct in Japan.

397. There are a number of definitions that need to be read together in establishing what the definition of a credit rating agency in Japan is, and the activities that a registered credit rating agency can conduct in Japan namely:

a. the definition of credit rating agency
b. the definition of credit rating business

c. the definition of those acts which are excluded from the definition of credit rating business
d. the definition of credit ratings

a) Definition of credit rating agency

398. Article 2 (36) of the Act[20] defines "credit rating agency" to mean:

"a person registered with the Prime Minister under Article 66-27 of the Act".

399. When reading the provisions of the Act quoted or referred to in this advice, reference to the Prime Minister should be read as a reference to the Commissioner of the JFSA; this is set out in Article 194-7 of the Act.

400. As can be seen, a credit rating agency is defined as a person, which CESR understands following further clarification on this point from the staff of the JFSA means a "legal person".

401. This legal person is defined as someone who becomes registered with the JFSA.

b) Definition of credit rating business

402. The Act Article 2 (35) defines "credit rating business" to mean:

"conducting in the course of trade such acts as determining Credit Ratings and either providing them to someone or making them available to the public (excluding those acts specified by Cabinet Office Ordinance as being unlikely to result in insufficient protection of investors in light of the scope of the other party to the act and any other manner in which the acts are conducted)."

403. Credit rating business is therefore the determination of credit ratings, which are then provided to someone or made available to the public.

404. As can be seen, the potential scope of the definition is broad, and upon further clarification from the staff of the JFSA CESR understands that the intention is that all business models are intended to be captured by the definition, so this includes a subscription based business model.

405. As can be seen, there are a number of "acts" which are excluded from the definition, which are set out in a Cabinet Office Ordinance.

c) Definition of acts that are excluded from the definition of credit rating business

406. Article 25 of Cabinet Office Ordinance No 14[21] of 1993 (which sets the definitions that apply to Article 2 of the Act) states that the following two acts are excluded from the definition of credit rating business:

(i) an act to determine a Credit Rating in response to a request from a rating stakeholder (meaning a rating stakeholder as defined in Article 66-33, paragraph (2) of the Act) and any other person, and to provide the Credit Rating only to such rating stakeholder or such other person (limited to the case where there is no potential risk of such rating stakeholder or such other person providing such Credit Rating for any third party or making them available to the public); and

20 Financial Instruments and Exchange Act (Act No. 65 of 2008) related to the Regulation of Credit Rating Agencies.
21 Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act (Ordinance of the Ministry of Finance No.14 of 1993) related to Regulation on Credit Rating Agencies.

(ii) an act to provide or making available to the public a grade by using symbols or figures (including texts or characters as set forth in paragraph (2) of the preceding Article), the results of an assessment of the credit status of a juridical person (including a juridical person as set forth in item (i) or (ii), paragraph (1) of the preceding Article; and limited to a juridical person which falls under the category of a Small and Medium-sized Enterprise Operator as listed in the items of paragraph (1) of Article 2 of the Small and Medium-sized Enterprise Basic Act (Act No. 154 of 1963) and which are persons not required to obtain an audit certification pursuant to the provision of Article 193-2, paragraph (1) or (2) of the Act or any other persons which also falls under the scope specified and disclosed in advance as persons similar thereto) derived primarily based on objective indicators of the credit status of said juridical person and in accordance with a computation given in advance."

407. As can be seen from the graphical representation of the JFSA's answers in Annex IIA, this means that the following are excluded from the definition of credit rating business:

a. The act of providing private credit ratings; and
b. The act of providing the results of computation using scoring models (only for small and medium sized enterprises).

408. The reason for these exclusions is that these activities are considered to be less likely to result in insufficient protection of investors in light of the scope of the counterparty and/or manner in which the acts are conducted.

409. CESR understands from further clarification from the staff of the JFSA that the meaning of b in paragraph **407** above relates to credit scoring.

410. Both the definition of credit rating business and those activities that are excluded from the definition make use of the term "Credit Ratings".

d) Definition of credit ratings

411. Article 2(34) of the Act defines "Credit Ratings" to mean:

"a grade which indicates, by using symbols or figures (including those specified by Cabinet Office Ordinance as being similar thereto), the results of an assessment of the credit status of Financial Instruments or juridical persons (including those specified by Cabinet Office Ordinance as being similar thereto) (such assessment shall hereinafter be referred to as a "Creditworthiness" in this paragraph) (such grade shall exclude that specified by Cabinet Office Ordinance as a grade determined mainly by factors other than Creditworthiness)"

412. As can be seen from the graphical representation of the JFSA's answers in Annex IIA, this means that a credit rating is a "grade" indicating the result of an assessment regarding the credit status (creditworthiness) of "financial instruments" or "legal persons" using symbols or figures, except for such grades specified in a Cabinet Office Ordinance being those that are determined mainly by factors other than credit status.

413. The definition of "financial instruments" is set out in Article 1 (Definitions) of the COODEF under Article 2 of the Act.

414. The definition of "those being similar to a juridical person" which is the term used in the definition of "credit rating" is set out in Article 24 (1) (Scope of Credit Ratings) of the Cabinet Office Ordinance on Definitions under Article 2 of the Act namely:

"(i) an organization without juridical personality;
(ii) an individual who carries out business;
(iii) a group of juridical persons or individuals; and
(iv) trust property."

415. The definition of what is meant by "those similar to symbols or figures" (as referred to in paragraph **411** above is set out in Article 24 (2) (Scope of Credit Ratings) of the COODEF namely:

"*Those similar to symbols or figures as specified by Cabinet Office Ordinance, as referred to in Article 2, paragraph (34) of the Act shall be a simple text or character showing sequential orders.*"

416. It is therefore clear that this is a fairly broad definition and as such will cover any form of symbol used by a credit rating agency.

417. In terms of those "grades" that are excluded from the definition of credit rating because they are determined by factors other than credit status these are set out in Article 24(3) (S cope of Credit Ratings) of COODEF[22]:

(i) Market Risk Rating (including fluctuations in interest rates etc)

"grades indicating the results of an assessment related to the fluctuation of the interest rate, value of currency, liquidity and quotations in the Financial Instruments Market, and any other indicators";

(ii) Fund Rating (performance of asset management etc)

"grades indicating the results of an assessment of the capability of the issuer of Securities in performing the management of assets or any other business similar thereto";

(iii) Servicer Rating (performance in managing and collecting debt etc)

"grades indicating the results of an assessment of the capability in performing businesses related to the management and collection of claims"

(iv) Trustee Rating (performance of trust companies in managing trust assets etc)

"grades indicating the results of an assessment of the adequacy of the operation of a trust business, such as capability for management of trust properties" and

(v) Any other rating that is determined by factors other than credit status

"in addition to what is listed in the preceding items, grades indicating the results of an assessment mainly determined by matters other than the credit status."

418. From the definitions above, although the definition of credit rating agencies in the Japanese regulatory regime is different from that of the EU definition as it reflects the manner in which the Japanese legal texts are put together, it is clear that overall:

- the scope of those ratings that are included within the definition of a credit rating and those ratings that are excluded from the definition;
- the scope of entities covered;
- the scope of financial instruments covered; and

22 Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act (Ordinance of the Ministry of Finance No.14 of 1993) related to the Regulation on Credit Rating Agencies.

- what is being assessed - namely creditworthiness

419. **The scope of activities of a credit rating agency that is subject to the Japanese legal and regulatory framework is well within the scope of what is covered under the definition of "credit rating" in Article 3(1)(a)[23] of the EU Regulation.**

Box 2

JAPANESE LEGAL DEFINITION OF WHAT A CREDIT RATING AGENCY IS AND THE ACTIVITIES A REGISTERED CREDIT RATING AGENCY CAN DO

420. CESR has no concerns with respect to these legal definitions.

a) Registration

421. As discussed in detail in paragraphs **347** to **373** above and as can be seen from the answer to question 3, there is a registration process for credit rating agencies in Japan.

422. Article 66-27 of the Act sets out that:

"A juridical person (including an organization without judicial personality for which a representative person or administrator has been designated; hereinafter the same shall apply in this Chapter, except in paragraph (1), item (ii) of the following Article and Article 66-47) engaged in Credit Rating Business may obtain the registration from the Prime Minister."

423. This definition means that a "juridical person" engaged in credit rating business the meaning of which is set out in paragraphs **402** to **410** "may obtain" registered status from the JFSA.

424. The use of the word "may" reflects the voluntary nature of the system explained in paragraph **253** to **268** above, in as much as, the Japanese Framework has a two tier system in respect of the oversight of credit rating agencies and only those agencies that wish to allow for their ratings to be used for regulatory purposes need to get registered.

425. From the cut-off date explained in paragraph **257** above, credit ratings from entities that are not registered as credit rating agencies with the JFSA can be used, but not for regulatory purposes. From October 2010, in relation to these ratings there will be additional obligations imposed on broker dealers requiring them to provide additional explanations regarding these ratings.

426. After registration the credit rating agency attains registered status, it then becomes regulated by the JFSA, and from October 2010, ratings from entities that are not registered as credit rating agencies with the JFSA come under the scope of JFSA supervision through the second tier of the system namely the broker dealer obligations discussed in paragraphs **260** to **268** above.

427. As explained in paragraph **85** above, when assessing the scope of what is covered in the third country legal framework CESR needs to make sure, that credit ratings which are used for regulatory purposes in other jurisdictions are subject to an equivalent set of legally binding rules, and to effective supervision and enforcement on an ongoing basis.

23 " Credit rating" means an opinion regarding the creditworthiness of an entity, a debt or financial obligation, debt security, preferred share or other financial instrument, issued using an established and defined ranking system of rating categories."

428. There is no reference in the definition of "Credit Rating Business" to the use of credit ratings for regulatory purposes, but CESR understands following clarification of this issue with the staff of the JFSA, that this is covered by virtue of the fact that the use of credit rating for such purposes is already set out in the Act through the previous designation system of DRA.

429. The scope of use of credit ratings issued by DRAs is broad thereby reinforcing the importance of attaining registered status in Japan.

430. On this basis, CESR concludes that credit rating agencies that want their credit ratings to be used for regulatory purposes in Japan will have to get registered with the JFSA.

b) Groups

431. In assessing the scope of the third country regime, it is also necessary to look at how group structures are regulated in that third country.

432. The application process, the requirement for which is set out in Article 66-28 (1) of the Act, (with additional requirements set out in Articles 296-298 COOFIN) requires that:

"A person who intends to obtain the registration set forth in the preceding Article shall submit a written application for registration containing the following matters to the Prime Minister. In this case, a foreign juridical person shall designate a representative person in Japan (limited to an individual who takes charge of business operations at all business offices or offices that said foreign juridical person establishes in Japan so as to engage in Credit Rating Business) or a person specified by Cabinet Office Ordinance as being equivalent thereto and submit said written application for registration…"

433. Part of the information that needs to be disclosed in the application form is as set out in Article 298 (ii) of the COOFIN and is related to "Associated Juridical Person" that jointly with the registration applicant performs Credit Rating Activities:

"(the following matters concerning the Associated Juridical Person of the registration applicant (excluding the another registration applicant or Credit Rating Agency, which falls under the registration applicant's Associated Juridical Person and which, jointly with the registration applicant, performs Credit Rating Activities)".

434. CESR has sought clarification of the meaning of this provision from the staff of the JFSA, from which it is CESR's understanding that if a credit rating agency's affiliates are involved in the issuance of Japan related ratings (discussed in paragraph **434** above), these affiliates need to be included in the application form,

435. In the event that these affiliates are not included in the application form, then the registered credit rating agency needs to have ultimate responsibility for the credit ratings issued by those affiliates by having the right to veto those credit ratings before they are published. In these cases the JFSA has the power to take action against the registered credit rating agency in respect of these credit ratings.

436. This stems from how the name lending prohibition set out in Article 66-34 of the Act works, as explained in Section III-2-2 (3) of the Guidelines which states:

"(3) Notes regarding the prohibition of name lending
With regard to credit rating agencies that conduct business as a group, in particular, in cases where a credit rating determined by an unregistered business operator within the

group is made to appear as though it was determined by a credit rating agency which is registered, and where the rating is provided or made available for inspection, it should be kept in mind that such instances could fall under the category of name lending, which is prohibited under Article 66-34 of the FIEA.
On the other hand, for a credit rating in which an unregistered business operator within the group is involved in its determination, in cases where:
• the credit rating agency examines whether the business activity pertaining to the said credit rating has been conducted appropriately under an adequate operational control system and in accordance with the rating policy, etc. of the said credit rating agency; and
• after having verified that there are no problems, the credit rating agency approves the determination of the said credit rating, or the credit rating committee passes a resolution (if the credit rating is found to have problems, then the approval of or resolution on the said credit rating is not conducted),
it should be kept in mind that the said credit rating, which has either been approved by the credit rating agency or resolved by the credit rating committee, will be recognized as having been determined by the credit rating agency, and will not fall under the category of name lending to an unregistered business operator within the group."

437. As such, part of the information that needs to be included in the application form[24], includes the identification of the companies and registered offices from which Japan related ratings are to be issued from as these ratings, irrespective of where they are issued from, fall within the scope of the JFSA's supervision, and the JFSA has the power to require information and carry out inspections against any affiliate irrespective of where they are located. Moreover, the JFSA has the power to apply sanctions in respect of credit rating agencies registered with them.

438. The treatment of each member of the group from an application perspective, depends on whether or not it is involved in the issuance of Japan related ratings and/or the development of the operational control system that is being presented as meeting the requirements for registration.

439. If the member of the group is only involved in the issuance of Japan related ratings and does not work together with another member of the group in developing the group's operational control system, then this member of the group is classified as an "affiliate" in the application form.

440. If a member of the group is involved in the development of the group's operational control system, then it is treated as a separate legal entity for registration purposes. A member of the group can only be considered as jointly developing the operational control system with another member of the group if both of them are registered with the JFSA.

441. As such, group applications fall into two categories, those credit rating agencies applying for registration where each member of the group is included as an affiliate and they only work together to issue Japan-related ratings, and those where a credit rating agency applying for registration needs to work together with other credit rating agencies in the group in developing its operational control systems, in which case each member of such a group needs to register with the JFSA as a separate applicant. And to be included as affiliates in each other's application forms.

442. CESR considers it necessary to point out this difference because, as explained in the JFSA answer to question 6, the Japanese take a pragmatic approach to the treatment of groups, so that when assessing the credit rating agencies application for registration, consideration is given to the **overall group's operational practices**, so that a number of requirements that the credit rating agency

24 The details of this are set out in Article 66-28(1) of the Act. .

has to comply with as part of the registration process, will be considered as being met by the group as a whole.

443. Namely, credit rating agencies that perform business as a group that are registered with the JFSA, are allowed to jointly comply with the requirements concerning: (a) operational control systems, (b) preparation and announcement of the rating policy, (c) record-keeping, and (d) explanatory documents, as discussed below.

(a) Operational control system

444. As set out in Article 306(5) of the COOFIN:

"In cases where two or more Credit Rating Agencies (limited to the cases where said two or more Credit Rating Agencies are Associated Juridical Persons, and where they share the same Representative Persons in Japan or a person as set forth in Article 297) are to jointly carry out Credit Rating Activities in the course of trade, said two or more Credit Rating Agencies may jointly establish their operational control systems."

445. According to Section III-2-1 of the Guidelines, even in this case, the credit rating agencies that conduct business as a group and that are registered with the JFSA:

"need to develop an appropriate system in view of the characteristics, size, complexity and other attributes of the business conducted by each individual credit rating agency".

446. CESR notes that Section III-2-1 of the Guidelines makes it clear that no part of the operational control systems may be assigned to an unregistered business operator, even if it is a credit rating agency within the group. In addition, there is a need to ensure that there is appropriate cooperation between the board of directors of each credit rating agency.

447. CESR understands following further clarification by staff of the JFSA on the provisions relating to groups that the same conditions apply in respect to the other requirements discussed in paragraphs **448** to **454** below.

(b) Rating Policy

448. Credit rating agencies that are registered with the JFSA and conduct business as a group are, under certain conditions, permitted to jointly prepare and announce their rating policy.

449. Namely, under Article 314(2) of the COOFIN:

"In cases where two or more Credit Rating Agencies (limited to the cases where said two or more Credit Rating Agencies are Associated Juridical Persons, and where they share the same Representative Persons in Japan or a person as set forth in Article 297) jointly perform Credit Rating Activities in the course of trade, said two or more Credit Rating Agencies may jointly formulate and establish the Rating Policy, etc.)."

450. As indicated in Section III-2-3 (1)(iii) of the Guidelines, in such cases, the credit rating agency is expected to display, in an easy to understand manner, the names of the credit rating agencies which have jointly formulated and publicized the rating policy.

(c) Record-keeping

451. Credit rating agencies that are registered with the JFSA and conduct business as a group may jointly comply with the record-keeping requirements according to Article 315(3) of the COOFIN.

452. Namely, Article 315(3) of the COOFIN states that:

"In cases where two or more Credit Rating Agencies (limited to cases where said two or more Credit Rating Agencies fall under the category of Associated Juridical Persons, and where their Representative Persons in Japan or persons as set forth in Article 297 are the same) jointly perform Credit Rating Activities in the course of trade, said two or more Credit Rating Agencies may be jointly prepared for the books and documents."

(d) Explanatory Documents

453. Credit rating agencies that are registered with the JFSA and conduct business as a group are, under certain conditions, permitted to jointly draw up and make public their explanatory documents.

454. Namely, Article 319(2) of the COOFIN provides that:

"In cases where two or more Credit Rating Agencies (limited to cases where said two or more Credit Rating Agencies fall under the category of Associated Juridical Persons, and where their Representative Persons in Japan or persons as set forth in Article 297 are the same) jointly perform Credit Rating Activities in the course of trade, said two or more Credit Rating Agencies may jointly prepare and announce the explanatory documents."

455. In such cases, as indicated in Section III-2-3 (2)(iii) of the Guidelines, the items listed in the explanatory documents are expected to be described for each credit rating agency, except for those items for which such a description would be difficult (for example, the development of operational control systems, an outline of the rating policy, etc.).

456. In addition as further discussed in the exemptions section in paragraphs **463** to **480** below, as set out in Article 306(6) of the COOFIN, a credit rating agency that is a foreign corporation may, with the approval of the Commissioner of the JFSA be excluded from a number of obligations relating to the development of the operational control system, which as explained in paragraphs **279** to **285** above, forms a large part of the overall Japanese regime.

457. The exemption applies only in relation to the offices that are located outside of Japan in cases set out in Article 306(6) of the COOFIN, where as described in Section III-3-3 of the Guidelines:

- the JFSA considers that the credit rating agency can conduct its business "fairly and appropriately by implementing other measures"; and
- if it is recognised that the credit rating agency is being appropriately supervised by the authorities of its home country with respect to the fair and appropriate conduct of the business as a result of implementing the alternative measures.

458. Those responsible for reviewing and approving the application are instructed in the Guidelines to take these matters into consideration, and it is made clear that in the event that approval for registration is granted and subsequently a problem is found in relation to the alternative measures, the supervisory departments are guided to consider taking the necessary supervisory action, including rescission of the approval of the registration as set out in Article 306 (8) of the COOFIN.

459. The exemption that can be granted applies to the following aspects of the operational control system that the credit rating agency has to have in place:

- Rotation rule;
- Supervisory Committee;
- Internal control systems;
- Requirements to manage conflicts of interest; and
- Reasonable measures to enable a third party to examine the validity of the credit rating of a structured finance product from an independent standpoint.

460. The legal basis for these exemptions are set out in the following Articles of the COOFIN: (i) Article 306(2) in respect of the rotation rule; (ii) Article 306(3) in respect of the Supervisory Committee, and (iii) the other three requirements set out in paragraph **474** can be excluded by virtue of Article 306(6).

461. These rules are discussed in the exemptions section in paragraphs **463** to **480** below.

Box 3

TREATMENT OF GROUPS

462. CESR has no concerns regarding the treatment of groups, or the pragmatic approach that the JFSA takes in allowing credit rating agencies at a group level a certain degree of flexibility in relation to how they jointly meet the requirements of the operational control system namely, rating policy, explanatory documents and record keeping, and does not consider this to interfere with the ability of these requirements to meet the objectives of the EU requirements.

c) Exemptions that can be granted

463. As explained in paragraph **80** above, if exemptions are permissible, CESR needs to verify that such exemptions do not hamper compliance with the EU Regulation. As can be seen from the JFSA's answer to Question 7 set out in Annex II of this advice, the Japanese regulatory regime does offer some exemptions for credit rating agencies seeking registered status.

464. There are two sets of exemptions that can be applied, one set for all credit rating agencies, and another set of exemptions that apply for foreign credit rating agencies that form part of a group.

465. The exemptions relate to aspects of the operational control system requirements and can be applied on a case by case basis.

466. The JFSA is very transparent regarding both the nature of the exemptions that can be granted, and the grounds for approval of the exemption.

Exemptions that can be applied to all credit rating agencies

467. The first set of exemptions that is applicable to all credit rating agencies deals with the rotation rule and the requirements on the supervisory committee as set out in Articles 306(2), (3) of the COOFIN.

468. Articles 306(2) and (3) of the COOFIN set out the exemptions as follows:

(a) Rotation Rule

"The provision of item (ii) of the preceding paragraph shall not apply in the case where, taking into account the number of Officers and employees of the Credit Rating Agency, the nature, size, and complexity of the Credit Rating Business and any other circumstances, the Credit Rating Agency is found to have difficulty in complying with said provision, and where it is found that implementation of any alternative measures would enable its Officers and employees to carry out its business independently from the Rating Stakeholder and in a fair and faithful manner, provided that approval from the Commissioner of the Financial Services Agency shall be obtained.

(b) Supervisory Committee

(3) The provision of item (xvii) of paragraph (1) shall not apply in the case where, taking into account the number of Officers and employees of the Credit Rating Agency, the nature, size, and complexity of the Credit Rating Business and other circumstances, the Credit Rating Agency is found to have difficulty in complying with said provision, and where it is found that implementation of any alternative measures would enable the Credit Rating Agency to implement properly the measures listed in the items of that paragraph (excluding item (xvii)), provided that approval from the Commissioner of the Financial Services Agency shall be obtained."

469. The first reference in Article 306(2) of the COOFIN is to the rotation rule, and the second reference in Article 306(3) of the COOFIN is to the Supervisory Committee.

470. In case where a credit rating agency intends to obtain an approval to be exempted from the rotation rule or the supervisory committee requirements, it shall submit a written application to the JFSA under Article 306(4) of the COOFIN, which provides, among other things (i) an explanation of the relevant reasons, (ii) a document describing the number of its officers and employees, (iii) a description of the nature, size, complexity and any other circumstances of its credit rating business, and (iv) a description of alternative measures intended to be adopted.

471. Although there is no specific provision in the Guidelines that applies in respect of these exemptions, upon further clarification of this issue with the staff of the JFSA CESR understands that in the event that these exemptions would be applied for, then the supervisory departments would when considering the request for these exemptions look at the provisions of the Guidelines that refer to the corresponding exemptions that apply to foreign credit rating agencies under Article 306(6) of the COOFIN that are discussed in paragraph **476** below.

472. In addition, the Commissioner of the JFSA can even after granting the exemption, change or rescind it as set out in Article 306(8) of the COOFIN.

Exemptions that can be applied in respect of foreign credit rating agencies

473. In respect of the second set of exemptions, this applies only to foreign credit rating agencies. The JFSA takes a pragmatic approach to groups, and as such, in addition to the two exemptions that can be applied to all credit rating agencies, the following five exemptions can also be applied to foreign credit rating agencies as set out in Article 306(6) of the COOFIN as follows:

"The provision of paragraph (1) (limited to item (ii), item (iv), item (vii), sub-item (a) 3.to

5. inclusive, item(ix) and item (xvii), and excluding the provisions pertaining to business office or office located in Japan)) shall not apply to cases where the Credit Rating Agencies (limited to a foreign juridical person; hereinafter the same shall apply in this paragraph and the following paragraph) are deemed to perform their business fairly and adequately by taking other alternative measures and the said Credit Rating Agencies are subject to appropriate supervision by the Foreign Administrative Organ, etc. on the proper functioning of such alternative measures for the fair and adequate implementation of business, provided that approval from the Commissioner of the Financial Services Agency shall be obtained."

474. As explained, the second set of exemptions apply to the requirements pertaining to:

- rotation rule
- internal control system;
- conflicts of interest management;
- reasonable measures to enable a third party to examine the validity of the credit rating of a structured finance product from an independent standpoint; and
- supervisory committee

475. A foreign credit rating agency that intends to benefit from one or more of the above exemptions shall submit a written application for approval to the Commissioner of the JFSA under Article 306(7) of the COOFIN as detailed in paragraph **477** below.

476. In terms of what the JFSA needs to take into consideration when approving these exemptions, this is set out in the Guidelines in Section III-3-3 (1) for the rotation rule, III -3-3 (2) for the internal control system, Section III-3-3 (3) for the conflict of interests management, Section III-3-3 (4) for the examination of the validity of the rating related to a structured finance instrument as follows, and Section III-3-3 (5) for the supervisory committee as follows:

(a) rotation rule III-3-3- (1):

"*Exclusion from the application of "measures pertaining to instances where a person in charge of rating is consecutively involved in processes relating to the determination of a credit rating on a matter in which the same rating stakeholder has an interest (rotation rule)"*
From the perspective of ensuring the quality of the rating process and keeping collusive relationships with rating stakeholders in check, whether the credit rating committee functions effectively, and whether the rating process has been properly built, such as by ensuring restraint through the internal audit division. Also, whether the credit rating agency has taken appropriate measures for preventing entrenchment in the process for the appointment of person in charge of ratings."

(b) internal control system (III-3-3 (2)):

"Exclusion from the application of "measures for ensuring the appropriateness of the business of a credit rating agency (internal control system)"
Whether the credit rating agency has built solid internal control systems for ensuring the appropriateness of business, in accordance with the laws and regulations of the home country of the said foreign corporation."

(c) conflicts of interest management (III-3-3 (3)):

"Exclusion from the application of "measures for preventing conflicts of interest related to the credit rating business"
(i) Exclusion from the application of "measures for ensuring that the interests of investors are not harmed in the determination of a credit rating on a matter in which a rating stakeholder has an interest, in certain cases where there is a potential conflict of interest between the credit rating agency and the said rating stakeholder"
Whether the credit rating agency has taken appropriate measures for preventing conflicts of interest related to the credit rating business of the said foreign corporation, in accordance with the laws and regulations of the home country of the said foreign corporation.
(ii) Exclusion from the application of "measures for preventing person in charge of ratings from approaching a rating stakeholder for the purpose of being employed as an officer of that rating stakeholder"
Whether the credit rating agency has taken appropriate measures for preventing credit rating activities from being unduly influenced, in such cases as where a person in charge of rating attempts to gain employment as an officer of a rating stakeholder.
(iii) Exclusion from the application of "measures for examining the validity of a credit rating on a matter in which a rating stakeholder has an interest, and in which a credit rating analyst was involved in processes relating to its determination in the two years prior to the date of his/her resignation, in cases where the said credit rating analyst who is no longer an officer or employee of the credit rating agency has gained employment as an officer of the said rating stakeholder"
Whether the credit rating agency has properly established a policy and procedures for examining the results of past work of a credit rating analyst in cases where the said credit rating analyst has taken up alternative employment as an officer of a rating stakeholder."

(d) measures for the examination of the validity of the rating related to a structured finance instrument (III-3-3(4))
"Exclusion from the application of "measures for enabling a third party to examine from an independent standpoint the validity of a credit rating related to asset securitization products"
Whether the credit rating agency has implemented measures whereby an independent third party can examine the validity of a credit rating related to asset securitization products, in accordance with the laws and regulations of the home country of the said foreign corporation."

(e) Supervisory Committee III-3-3-(5):

"Exclusion from the application of "measures pertaining to the establishment of a supervisory committee"
Whether the credit rating agency has built solid governance for ensuring appropriateness of business by having a consultative body, which includes outside directors and other external persons, examine the appropriateness of the operational control system."

477. When applying for an exemption credit rating agencies need to provide additional information as well as the reason for asking for the exemption and a legal opinion as set out in Article 306 (7) of the COOFIN as follows:

"In cases where the Credit Rating Agency intends to obtain an approval pursuant to the preceding paragraph, it shall submit to the Commissioner of the Financial Services Agency a written application for approval, attaching thereto the following documents:
(i) a written statement of reasons;
(ii) a document describing the details of other alternative measures
(iii) a document proving that the Credit Rating Agency is subject to the appropriate supervision by the Foreign Administrative Organ, etc.
(iv) a document containing any other matters that will be helpful; and
(v) a legal opinion stating that the matters related to laws and regulations written in the documents of each of the preceding items are true and accurate, which shall be prepared by legal profession, as well as a copy of the relevant provisions of the applicable laws and regulations referred in said legal opinion."

478. In addition, the Commissioner of the JFSA can even after granting the exemption, change or rescind it as set out in Article 306(8) of the COOFIN.

Box 4

EXEMPTIONS

479. There are a limited number of exemptions that may be applied to all credit rating agencies and other to foreign credit rating agencies, subject to the Commissioner of the JFSA's approval.

480. CESR has no concerns in relation to these exemptions and how the JFSA will exercise its discretion in granting the approval, since the exemptions can be applied only in limited circumstances and are subject to a number of conditions, including the implementation of alternative measures.

c) whether or not the authority in question is prohibited from influencing the content of ratings and methodologies

481. As explained in paragraph **77** above, for equivalence to be said to be in place, the legal framework needs to explicitly prohibit interference by the authorities with the content of credit ratings and credit rating methodologies.

482. Article 325 (Matters to be Taken into Account for Purpose of Application) of the COOFIN states:

"In cases where the Commissioner of the Financial Services Agency exercises the authority under Article 66-41, Article 66-42, paragraphs (1) or (2) or Article 66-45, paragraph (1) of the Act, he/she shall pay attention not to be involved in the individual Credit Ratings or the specific details of the method of Credit Assessment."

483. This prohibition is equivalent to the one in the EU as it prohibits the regulation of the substance of credit ratings or the procedures by which such ratings are determined.

484. CESR considers that objective of this EU requirement is met.

Box 5

WHETHER OR NOT THE AUTHORITY IN QUESTION IS PROHIBITED FROM INFLUENCING THE CONTENT OF RATINGS AND METHODOLOGIES

485. The prohibition to interfere with credit ratings and credit rating methodologies is set out in the Act.

Box 6

SCOPE OF THE JAPANESE REGULATORY AND SUPERVISORY FRAMEWORK

486. CESR considers that the objectives of the EU requirements referred to in this Section are met through the provisions on registration of credit rating agencies that want to enable their ratings to be used for regulatory purposes, and the prohibition for the JFSA to interfere with the substance of credit ratings and the methodologies to determine ratings.

487. CESR notes that there are certain differences, none of which raises any concern.

488. Registration is only required for those credit rating agencies that want to attain registered status in order to enable their credit ratings to be used for regulatory purposes.

489. The regime has a pragmatic approach to group structures, allowing certain requirements to be jointly met by credit rating agencies that perform business as a group, provided certain conditions are met.

490. The regime includes certain limited exemptions that can be granted to all credit rating agencies, as well as certain exemptions that may be granted only to foreign credit rating agencies. In both cases, the exemption is subject to the Commissioner of the JFSA's approval, involving the assessment of whether or not a number of conditions are met.

B. Corporate Governance

491. The EU mandate on assessing the equivalence between certain third country legal and supervisory frameworks and the EU regulatory regime for credit rating agencies required CESR to check at least the following issues in this Section:

Extract from the mandate

▪ Two independent directors on the CRA's administrative or supervisory board are tasked with monitoring the credit rating policy, effectiveness of the internal quality control system as well as the internal controls and measures established to deal with conflicts of interests.

492. The requirements that should be covered in this Section as set out in paragraph **99** are:

a) an administrative or supervisory board ("board");
b) at least 2 independent members of the board tasked with monitoring the:
   I credit rating policy;
   II effectiveness of the internal quality control system;
   III internal controls and measures established to deal with conflicts of interest.

493. In addition, credit rating agencies have to ensure that:

a) the compensation of the independent members of the board is not linked to the business performance of the credit rating agency, and that their judgment can be exercised in an independent manner;
b) the term of office of the independent members of the administrative or supervisory board is for a pre-agreed fixed period and is not renewable;
c) a term limit for the independent members of the board is defined;
d) the majority of members of the board, including independent members have sufficient expertise in financial services;
e) if the credit rating agency issues credit ratings of structured finance instruments, at least one independent member and one other member of the board has in-depth knowledge and experience at a senior level of the markets in structured finance instruments;
f) in addition to the overall responsibility of the board, the independent members of the administrative or supervisory board have the specific task of monitoring:
   I development of credit rating policy;
   II development of the methodologies the credit rating agency uses in credit rating activities;
   III effectiveness of internal control mechanisms in relation to credit rating activities;
   IV effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or adequately managed and disclosed;
   V compliance and governance processes including the efficiency of the review function.

494. In addition to the above, CESR's approach to assessing the equivalence of the EU Regulation's corporate governance requirements, as set out in paragraph **101** above, makes it clear that this is an area where CESR anticipates there may be differences, and **as such is not expecting** all of the EU Regulation's requirements to be in place.

495. CESR considers the objectives of these requirements taken as a whole (as explained in paragraph **95** above), are to ensure that senior management is responsible and legally accountable for ensuring:

a. that credit rating activities are independent;
b. that there is proper management of conflicts of interests; and
c. compliance with the legal requirements of the regulatory framework.

496. As explained in paragraphs **102** - **105** above, when assessing equivalence in this area, CESR considers that it should assess whether or not at least the following requirements are in place:

a. there needs to be some form of requirement that a corporate governance structure is in place to ensure that senior management is accountable;
b. there needs to be a clear allocation of the following monitoring tasks in terms of ultimate responsibility to the independent members of senior management:
- the development of credit rating policy and of methodologies used by the credit rating agency in its credit rating activities;
- effectiveness of the internal quality control system;
- effectiveness of measures and procedures instituted to ensure that any conflicts of interests are identified, eliminated or managed and disclosed;
- compliance with governance processes.

497. CESR sets out an analysis of all the requirements included in the Japanese regulatory framework that correspond to those listed in paragraphs **99** and **100** above as well as a discussion regarding whether or not it considers that the Japanese provisions meet the objectives of the requirements.

a. Senior management responsibility and accountability

498. Before discussing the relevant Japanese requirements in this area, CESR points out that the Japanese legal and supervisory requirements make extensive use of the word "Supervisory Committee" which it considers to be the equivalent of what the EU Regulation defines as administrative or supervisory board[25].

499. The EU Regulation requires that senior management should be responsible and legally accountable for ensuring a number of corporate governance issues as outlined above and that at least two of its members are independent.

500. In Japan, the Act itself does not prescribe corporate governance rules in detail, but Article 66-32 (set out in paragraph **277)** and Article 66-33 of the Act impose an obligation on credit rating agencies to execute the credit rating business fairly and independently, and to have an operational control system, the details of which are set out in the COOFIN.

501. Art 66-33(1) of the Act states that:

"A Credit Rating Agency shall establish operational control systems for the fair and appropriate performance of its Credit Rating Business, pursuant to the provisions of Cabinet Office Ordinance in order to conduct its Credit Rating Business with fairness and adequacy."

502. Extensive requirements for setting up operational control systems are outlined in detail in Article 306 of the COOFIN. Among other requirements, Article 306 (1)(v) contains the following measures to secure compliance with laws and regulations:

" (a) the formulation of policies and procedures for compliance with laws and regulations, etc..;

[25] A credit rating agency needs to establish a Supervisory Committee that meets the requirements of Article 306(1)(xvii) of the COOFIN unless it already has another board or committee that in accordance with its corporate governance law satisfies these requirements.

(b) the formulation of policies to clearly define responsibilities with regards to compliance with laws and regulations, etc., such as the appointment of a Chief Compliance Officer;
(c) the following measures in relation to handling cases where the act of an employee was found to be in violation of the laws and regulations, etc.:
1. the measures to notify officers and the chief compliance officer with an account of the act of any employee of a credit rating agency committed in violation of laws and regulations, in cases where any such act has been discovered;
2. the appropriate measures to be implemented by the officers and chief compliance officer as notified above, so as to prevent the credit rating agency from committing any act which may violate laws and regulations, etc.; and
3. the measures to ensure that the person who has made the notification shall not be treated unfavourably on account of having made such notification;"

503. In addition, Article 306(1)(xvii) of the COOFIN makes reference to the establishment of a Supervisory Committee that has to meet the following requirements:

"(a) that one-third or more of the committee members (two or more committee members, in cases where the number of committee members is three or less) are persons not falling under the category of officer (excluding an auditor or any other position equivalent thereto) or employee (hereinafter referred to as the "Relevant Officers and Employees, etc." in this item (a)) of the Credit Rating Agency, its subsidiary juridical person, any other juridical person which holds such Credit Rating Agency as its subsidiary juridical person or any subsidiary juridical person of any other juridical person which holds such Credit Rating Agency as its subsidiary juridical person (excluding such credit rating agency), and are persons not having assumed the positions of the relevant officers and employees, etc. within the past five years (such committee member shall be hereinafter referred to as the "Independent Member" in this chapter);
(b) that the majority of the committee members have expert knowledge related to finance,
(c) that the amount of the remuneration, etc. of the independent members shall not be affected by the performance outcome of the credit rating business of the credit rating agency;
(d) that during his/her respective tenures, the Independent member will not be dismissed in opposition to his/her intension, except in the cases where he/she has committed any wrongful act, where he/she is found to have committed any breach of his/her obligations in the course of his/her duties, or where so required under the laws and regulations;
(e) that the opinions of the independent members shall be periodically submitted to the supervisory committee."

504. The Guidelines (Section III-2-1 (16)) add more detail of what credit rating agencies should consider when setting up the Supervisory Committee.

"Measures pertaining to the establishment of a supervisory committee

(i) whether the credit rating agency has ensured the independence of the supervisory committee in accordance with the purpose of system.
(ii) whether the credit rating agency has clearly established the authority and responsibility of the supervisory committee, and whether it has properly established a process for appointing committee members, a policy for administering the supervisory committee, and a process for independent members to periodically submit their opinions.
(iii) whether the supervisory committee exercises its invested authority properly, and conducts effective supervisory activities.
(iv) whether the supervisory committee reports to the management team, without delay, any important issues identified in the process of its supervisory activities.

(v) whether the credit rating agency makes appropriate improvements with respect to matters pointed out by the supervisory committee. Also, whether the supervisory committee appropriately examines the progress of improvements made with regard to those matters raised."

505. Credit rating agencies are required, as part of the application process, to provide information to the JFSA on the names of the members of the Supervisory Committee, the method of appointment of these members and the operational policies of the Supervisory Committee, together with a document on the grounds for independence of the independent members of the Supervisory Committee.[26]

506. In addition, the operational policies of the Supervisory Committee, the names and method of appointment of the members (including a basic "stance" on the independence of the independent members) is to be included in the explanatory documents a credit rating agency is required to prepare and publish for each business year[27].

507. A credit rating agency is required to maintain the minutes of the Supervisory Committee for at least 5 years according to Article 315(vii) of the COOFIN.

508. As one can identify from the paragraphs above, the listed requirements are similar to the ones set out in paragraphs **492** and **493**, in particular the set up of a Supervisory Committee and relevant requirements in relation to the staffing of such a Committee.

509. As outlined in paragraph **467** above credit rating agencies registering in Japan could be exempted from establishing a Supervisory Committee according to Articles 306 (3) and (6) of the COOFIN.

510. However, as explained in detail in paragraphs **468** and **473** above, there are a number of requirements that have to be met before the exemption can be granted. In particular relation to the exemption that can be granted to foreign credit rating agencies under Article 306(6) of the COOFIN, Section III-3-3 (5) of the Guidelines provides that the supervisory departments need to consider whether there is a suitable alternative by requiring that the credit rating agency has built solid governance for ensuring the appropriateness of its business by having a consultative body which includes outside directors and other external persons examine the appropriateness of the operation control system.

511. Although there is no specific provision in the Guidelines that applies in respect of the exemption, under Article 306(3) of the COOFIN upon further clarification of this issue with the staff of the JFSA, CESR understands that in the event that this exemption would be applied for, then the supervisory departments would when considering the request for this exemptions look at the provisions of the Guidelines that refer to the corresponding exemption that apply to foreign credit rating agencies under in Article 306(6) of the COOFIN that is discussed in paragraph **510** above**.**

512. Based on the information outlined in paragraph **502** above, CESR understands that the Supervisory Committee has to review all of the operational control system requirements.

513. Furthermore the Supervisory Committee should ensure the actual and proper implementation of the control systems.

26 Article 298(v), Article 299(xxxv) and Article 300(v) of the COOFIN.
27 Article 318(1)(iii)(m) of the COOFIN.

Independence of the members of the Supervisory Committee

514. In respect of the requirement in the EU that at least 2 members of the administrative or supervisory board are independent, the Japanese regulatory regime makes specific reference to the independence of executives and employees in Article 66-32 of the Act which states that:

"A Credit Rating Agency as well as Officers and employees thereof shall execute their business in good faith and fairly from an independent standpoint."

515. In addition, according to Article 306 (1)(xvii)(a) of the COOFIN, independent members of the Supervisory Committee could only be classified as such, in cases where they were not employed by the credit rating agency and did not take the position of officer of the credit rating agency in the last five years:

"a) that one-third or more of the committee members (two or more committee members, in cases where the number of committee members is three or less) are persons not falling under the category of Officer (excluding an auditor or any other position equivalent thereto) or employee (hereinafter referred to as the "Relevant Officers and Employees, etc." in this item (a)) of the Credit Rating Agency, its Subsidiary Juridical Person, any other juridical person which holds such Credit Rating Agency as its Subsidiary Juridical Person or any Subsidiary Juridical Person of any other juridical person which holds such Credit Rating Agency as its Subsidiary Juridical Person (excluding such Credit Rating Agency), and are persons not having assumed the positions of the Relevant Officers and Employees, etc. within the past five years (such committee member shall be hereinafter referred to as the "Independent Member" in this Chapter)."

516. As indicated in paragraph **503** above, the remuneration of the independent members needs to be established in such a way as to be independent from the performance of the credit rating activities. In addition, the opinions of the independent members shall be submitted to the Supervisory Committee on a periodic basis. Limitations applying regarding the grounds for dismissal of independent members contribute to reinforce their independence.

517. In addition, Article 300 (v) of the COOFIN imposes the disclosure obligation on the credit rating agency to attach as part of the documents that need to be provided in the application process:

"a document describing the reasons based on which the Independent Members (meaning Independent Members as set forth in Article 306, paragraph (1), item (xvii), sub-item (a)) of the Supervisory Committee are deemed to be independent"

518. Section III -2-1 (16) of the Guidelines set out in paragraph **504** above adds that the credit rating agency has to ensure the independence of the Supervisory Committee and to properly establish a process for independent members to periodically submit their opinions.

Differences between the EU Regulation and the Japanese regulatory framework in respect of the nature of the administrative or supervisory board

519. The Japanese regulatory regime does not formally require a fixed term limit for members of the Supervisory Committee to ensure their independence, but CESR understands following additional clarification on this point from the staff of the JFSA that the JFSA expects a credit rating agency to explain alternatives arrangements to the ones already listed above on how independence can be achieved.

520. CESR understands that a general requirement for members of the Supervisory Committee to have expertise pertaining to finance is not limited to specific financial disciplines and includes knowl-

edge on structured finance. CESR recognises that this general approach avoids the risk of having only a limited pool of individuals eligible for the position of member of the Supervisory Committee.

521. In addition, CESR understands that the JFSA expects the corporate governance rules of the country where the credit rating agency was incorporated to apply.

Box 7

ESTABLISHMENT OF A SUPERVISORY OR ADMINISTRATIVE BOARD

522. The Japanese legislative on credit rating agencies does contain requirements on corporate governance.

523. There is a requirement to establish a Supervisory Committee and, according to the Guidelines, the JFSA does consider the corporate governance structure of the credit rating agency as part of assessing its eligibility for registration, and for meeting its on-going obligations.

524. At least one third of the members of the Supervisory Committee have to be independent.

525. Overall, the Japanese regulatory framework meets the EU requirements in respect of the administrative and supervisory board, as further explained in paragraphs 498 et seq. above and the following paragraphs below, through requirements which are similar to those of the EU Regulation.

b. there needs to be a clear allocation of the following monitoring tasks in terms of ultimate responsibility to the independent members of senior management:

526. CESR understands that the Supervisory Committee is responsible for all operational control systems but there is no specific provision that allocates the responsibility of the monitoring tasks to only the independent member of the Supervisory Committee.

527. Article 306 (1)(xvii) of the COOFIN requires the Supervisory Committee to be responsible for monitoring and ensuring implementation of all measures set out in Article 306 (1)(i) to (xvi) of the COOFIN.

528. No reporting line of the Supervisory Committee is set out in the Japanese framework, in order to allow the individual credit rating agency to set up a committee and the relevant reporting lines according to the needs of its organisational structure. However, as a credit rating agency has to be a legal entity and as such abide by corporate governance law.

529. According to Section III-2-1 (16)(iv) of the Guidelines, the Supervisory Committee should report to the management team, without delay, any important issues identified in the process of its supervisory activities.

530. According to Section III-1 of the Guidelines, in conducting examination of the governance of a credit rating agency, the supervisory departments shall examine whether the tasks of the board and individual directors are appropriately allocated taking into account the credit rating agency's size and complexity and other attributes of the credit rating agency's business.

531. CESR understands following additional clarification from the staff of the JFSA that ultimate responsibility for the activities of the Supervisory Committee will depend upon the corporate govern-

ance law to which the credit rating agency in question has to abide by based on its country of incorporation and that Japanese law requires that the management board of a company has ultimate responsibility for the activities of the Supervisory Committee.

The development of credit rating policy, of methodologies used by the credit rating agency in its credit rating activities and effectiveness of the internal quality control system

532. As outlined in paragraph **526** above, the Supervisory Committee has to review all of the operational control systems requirements. It needs to ensure the actual and proper implementation of the operational control systems.

Effectiveness of measures and procedures instituted to ensure that any conflicts of interests are identified, eliminated or managed and disclosed

533. In respect of this EU requirement, this is met in the Japanese legal framework through Article 306 (1)(vii) of the COOFIN which requires a credit rating agency to implement measures to prevent any conflicts of interest which may arise in connection with the credit ratings business, this is further discussed in paragraphs **563** to **564** below, and paragraphs **574** to **578** below.

534. As outlined in paragraph **526** above, the Supervisory Committee is in charge of monitoring all of the operational control system requirements set out in Article 306 (1) of the COOFIN, and reference to the word "measures" means to have policies in place and ensure that they are complied with.

Compliance with governance processes

535. In respect of this EU requirement, in the Japanese legal framework this is covered by Article 306 (1)(v) of the COOFIN which contains a direct reference to the need for a credit rating agency to establish measures to ensure that it complies with laws and regulations.

536. In addition it is necessary for the credit rating agency to establish policies and procedures regarding its compliance with laws and regulations, as set out in Article 306(1)(v)(a) of the COOFIN.

537. By and large, CESR does consider that senior management is responsible for and legally accountable for ensuring that:

a) credit rating activities are independent;
b) that there is proper management of conflicts of interests;
c) compliance with the legal requirements of the regulatory framework.

538. The role of the Chief Compliance Officer is defined in Article 295(3)(vii) of the COOFIN as "*a person in charge of implementing measures so as to ensure Compliance with Laws and Regulations..*".

539. Annex I, Section A.6 of the EU Regulation stipulates that in order to enable the compliance officer to discharge its responsibilities properly and independently, the compliance officer shall not be involved in the performance of the credit rating activities that are monitored, and that its compensation shall not be linked to the business performance of the credit rating agency and shall be arranged as to ensure the independence of his judgment.

540. The compliance officer is also required to report regularly on the carrying out of his duties to the senior management and independent members of the administrative or supervisory board.

541. In Japan, there is not an express prohibition for the Chief Compliance Officer to be involved in the credit rating activities.

542. However, a credit rating agency is required, as part of its operational control systems, to implement measures to ensure that the remuneration payable to the Chief Compliance Officer would not be affected by the performance of the credit rating activities[28].

543. Information on the policy adopted by the credit rating agency for the remuneration of its officers and employees – including the Chief Compliance Officer – needs to be disclosed to the JFSA as part of the application process[29], as well as needing to be made available to the public in the explanatory documents that are required to be prepared and published for each business year[30].

544. There is no express obligation for the Chief Compliance Officer to report to the Supervisory Committee. However, the Supervisory Committee is responsible for ensuring appropriate implementation of the operational control systems, including policies and procedure for compliance with laws and regulations.

545. There is no explicit requirement that the Chief Compliance Officer has per se to be "independent", but CESR is comfortable following clarification of this issue from the staff of the JFSA that the Japanese requirements that are in place should in practice ensure the independence of this individual.

Box 8

CLEAR ALLOCATION OF SPECIFIC MONITORING TASKS IN TERMS OF ULTIMATE RESPONSIBILITY TO INDEPENDENT MEMBERS OF BOARD

546. The Supervisory Committee is responsible for all operational controls systems. However, there is no specific provision that allocates the responsibilities of the monitoring tasks to only the independent members of the Supervisory Committee.

547. CESR points out following clarification of this issue with the staff of the JFSA that ultimate responsibility for the activities of the Supervisory Committee will depend upon the corporate governance law to which the credit rating agency in question has to abide by based on its country of incorporation and that Japanese law requires that the management board of a company has ultimate responsibility for the activities of the Supervisory Committee.

Box 9

CORPORATE GOVERNANCE

548. Overall, corporate governance is a strong building block of the Japanese regulatory regime for credit rating agencies.

28 Article 306(1)(x)(a) of the COOFIN.
29 Article 299(xxx) of the COOFIN.
30 Article 318(1)(iii)(i) of the COOFIN.

549. The Japanese requirements for credit rating agencies, laid down in great detail in the Cabinet Office Ordinance on Financial Instruments Business, include provisions relating to corporate governance.

550. CESR considers that the requirements that are in place meet the objectives of this section in light of the following:

- There is a general obligation for the credit rating agency, its officers and employees to execute their responsibilities from an independent standpoint.
- The COOFIN requires Credit rating agencies operating in Japan to establish a Supervisory Committee.
- This Supervisory Committee is responsible for all operational controls systems and has to take on board independent members so that at least one-third of the members are independent.
- The ultimate responsibility for the activities of the Supervisory Committee will depend upon the corporate governance law to which the credit rating agency in question has to abide by based on its country of incorporation, Japanese law requires that the management board of a company has ultimate responsibility for the activities of the Supervisory Committee.
- Independence of Supervisory Committee members that need to be independent is achieved through the following requirements: (i) that their remuneration is not affected by the performance of the credit rating activities (ii) that their dismissal is only possible in limited situations related to conducting wrongful acts (iii) that they have not been employed by the credit rating agency or had a position of an "officer" during the last five years.
- How the independence of the Supervisory Committee members that need to be independent is achieved is something that has to be explained to the JFSA as part of the application process, and is subsequently disclosable to the public through the explanatory documents.
- Conflicts of interest management is part of the Japanese regulatory framework.
- Credit rating agencies are requested to establish policies and procedures regarding compliance with laws and regulations.

551. CESR believes that the objectives of the EU Regulation in the corporate governance section are met by the Japanese regulatory framework, but moreover, the framework includes the large majority of the EU requirements in this area.

552. CESR notes that the Commissioner of the JFSA can in certain limited circumstances grant credit rating agencies an exemption in respect of the establishment of the Supervisory Committee taking, into account among other things the number of officers and employees of the credit rating agency, its nature, size and the complexity of its business and other circumstances, provided that a number of conditions are met. In addition, an exemption from this requirement can be granted to foreign credit rating agencies subject to the approval of the Commissioner of the JFSA, provided that conditions aimed at ensuring that there is solid governance for enabling the appropriateness of the credit

rating agency's business are satisfied . These exemptions are further discussed in paragraphs 467 to 473 above.

553. CESR notes that there is no specific provision that allocates the responsibilities of the monitoring tasks to only the independent members of the Supervisory Committee however this does not have an impact on the overall conclusion set out in the paragraphs above.

C. Conflicts of Interest Management

554. The EU mandate required CESR to check at least the following issues in this Section:

Extract from the mandate

- A CRA identifies and eliminates (or manages and discloses) conflicts of interest.
- A CRA ensures that business interest does not impair the independence and accuracy of ratings.
- A CRA does not provide consultancy or advisory services; an exhaustive and limited list of ancillary services, which may be provided by a CRA, is defined in the third country legal framework;
- A CRA refrains from issuing a rating when it has direct or indirect interest in the entity asking for a rating;
- Rating analysts cannot make proposals or recommendations on the design of structured finance products;
- Rating analysts are not involved in the negotiation of the fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control;
- Rating analysts' compensation and performance evaluation is de-linked from the revenue they generate for the CRA;
- A stringent rotation policy is put in place (lead rating analysts to rotate client at least every 4 years)

555. As discussed in paragraph **107** above, conflicts of interest management is a core requirement of the EU Regulation in order to ensure that it meets the overall objective as set out in paragraph **33** above.

556. The EU Regulation sets out a large number of detailed requirements in this area set out in paragraphs **109** to **113** above, and in assessing equivalence, as discussed in paragraph **116** above, this is another area where CESR does not expect the third country laws and regulations to be as detailed or specific as those set out in the EU Regulation.

557. **CESR does however expect there to be robust provisions embedded into the law that cover actual or potential conflicts of interest management and disclosure**.

558. CESR considers the objectives of the EU Regulation's requirements in this area are to ensure:

a) objectivity, independence, integrity and quality of the credit ratings;
b) transparency about the credit ratings; and
c) to contribute to the protection of investors and financial markets.

559. In assessing the equivalence of the third country requirements against these objectives, of the requirements set out in the EU Regulation, CESR considers that in addition to the corporate governance requirements discussed in paragraphs **95** et seq., (whose objectives as explained above CESR considers the Japanese legal and supervisory framework meets), overall the objectives of each of the individual requirements set out in paragraphs **111** to **113** above should be met through provisions embedded in the law.

Japanese approach to conflicts of interest management

560. Conflicts of interest management is one of the key principles embedded into the Japanese legal and supervisory framework in respect of credit rating agencies.

561. In Japan conflicts of interest management is addressed by:

- ♦ specific provisions that deal with conflicts of interest (identification, prevention, management, disclosure);
- ♦ information that needs to be disclosed as part of the registration process and on on-going basis;
- ♦ other aspects of other provisions that deal with a number of EU requirements as discussed below in order to carry out business from an independent standpoint (so called *operational control systems*; Articles 66-32 and 66-33 of the Act and Article 306(1)(vii) of the COOFIN). It is based on a two step approach:

  a) first an obligation to implement measures to identify credit rating activities which entail any actual or potential conflicts of interest (so called *specified acts;* see Article 306(1)(vii)(a) COOFIN), and
  b) secondly, to then implement measures to secure that such acts would not adversely affect the interests of investors.

562. In addition, these requirements are further complemented by provisions specifying a number of prohibited acts, discussed in detail below.

563. Besides this general clause and as a part of the obligation to run an *operational control system*, Article 306(1)(vii)(a) of the COOFIN provides for a non-exhaustive list of specific measures (so called *measures for preventing conflicts of interest*) to be implemented by credit rating agencies, aiming at:

i. preventing personal trading of analysts which may entail conflicts of interest (Article 306(1)(vii)(a)(1) of the COOFIN);
ii. preventing participation of employees having potential conflicts of interest with *rating stakeholders*[31] (as defined in Article 307 of the COOFIN) in the rating determination process (Article 306(1)(vii)(a)(2) of the COOFIN);
iii. preventing credit rating agencies from undermining the interests of investors in the process of determining a credit rating of any matter in which *rating stakeholders* have an interest (as defined in Article 309 of the COOFIN), in cases where there are any potential conflicts of interest between the credit rating agency and the relevant rating stakeholder, as well as in any of the following cases (Article 306(1)(vii)(a)(3) of the COOFIN:
    - where the credit rating agency has been furnished with loans (including the guarantee of obligations and the offering of collaterals) by a rating stakeholder;
    - where the holder of five percent or more of the voting rights held by all the shareholders of the credit rating agency falls under the category of a rating stakeholder;
    - where the rating stakeholder acts as the underwriter of securities issued by the credit rating agency;
    - where the credit rating agency has been furnished by the rating stakeholder with a large amount of money or any other property benefit, as a consideration of services other than the services pertaining to credit rating activities;
iv. preventing persons in charge of rating from making any attempt to assume an employment by the rating stakeholder (Article 306(1)(vii)(a)(4) of the COOFIN);
v. implementing measures to verify the appropriateness of a credit rating of any matter in which a rating stakeholder has an interest, in cases where a rating analyst who is no longer employed by the credit rating agency has been employed by a rating stakeholder (limited to cases where the former analyst participated in determining such credit rating within two years prior to the end of the employment) (Article 306(1)(vii)(a)(5) of the COOFIN).

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31 CESR understands following clarification of this issue from the staff of the JFSA that the definition of "rating stakeholder" in Article 307 of the COOFIN does include the concept of related third party as set out in Article 3(1)(i) of the EU Regulation.

564. Furthermore, Article 306(1)(vii)(b) of the COOFIN provides for the disclosure ("measures to announce") of the types of *specified acts* which a credit rating agency has identified, and an outline of the measures for preventing conflicts of interest in an appropriate manner.

565. As specifically set out in the Guidelines, credit rating agencies also have to monitor the validity and effectiveness of the *specified acts* which they have identified (Section III-2-1- (6)-(i)-(c) of the Guidelines) as well as of the measures for avoiding conflicts of interest (Section III-2-1- (6)-(ii)-(c) of the Guidelines) in a timely and appropriate manner, and make revisions as necessary.

566. Offices of credit rating agencies registered in Japan which are located outside of Japan are subject to certain possible exemptions from the provisions on the prevention and management of conflicts of interest (namely obligations (iii) to (v) of the above list set out in paragraph **563** above) under the condition that they are deemed to perform their business fairly and adequately by taking other alternative measures, and that the said credit rating agencies are subject to appropriate supervision by the foreign supervisory authorities on the proper functioning of such alternative measures for the fair and adequate implementation of business, provided that approval from the Commissioner of the JFSA shall be obtained (Article 306(6) of the COOFIN).

567. Conflicts of interest are also already addressed during the registration process. The following documents need to be attached to the application for registration (Article 66-28(2)(ii) of the Act and Article 299(xxi)-(xxviii) of the COOFIN):

- the types of *specified acts* identified by the credit rating agency and the outline of the *measures for preventing (avoiding) conflicts of interest* (Article 299(xxi) of the COOFIN);
- the details of the measures to be implemented in order to prevent the person in charge of rating from conducting the sale and purchase or other transactions of securities which may entail any conflicts of interest (Article 299(xxii) of the COOFIN);
- the details of the measures to be implemented so as to refrain from providing to someone a credit rating of any matter in which *rating stakeholders* have interests or making them available to the public, in cases where the registration applicant or one of its employees has a close relationship with any *rating stakeholders* as set forth in Article 308 of the COOFIN (Article 299(xxiii) of the COOFIN);
- the details of the measures to be implemented to ensure that the interests of investors would not be adversely affected in the process of determining a credit rating of any matter in which *rating stakeholders* have interests, in cases where there may arise any conflict of interests between the registration applicant and the *rating stakeholders* (Article 299(xxiv) of the COOFIN);
- the details of the measures to be implemented to prevent persons in charge of ratings from making any approach in an attempt to assume the position of an officer or any other position equivalent thereto of the rating stakeholder (Article 299(xxv) of the COOFIN);
- the details of the measures to be implemented so as to verify the appropriateness of a credit rating of any matter in which *rating stakeholders* have interests, in cases where any rating analyst who no longer assumes the position of an employee of a registration applicant assumes the position of an officer or any other position equivalent thereto of the rating stakeholder (Article 299(xxvi) of the COOFIN);
- the details of the measures to be implemented for the announcement of types of specified acts and an outline of *measures for preventing (avoiding) conflicts of interest* in an appropriate (Article 299(xxvii) of the COOFIN);
- the details of the measures to be implemented so that activities pertaining to ancillary businesses and any other lines of business would not unreasonably affect the credit rating activities (Article 299(xxviii) of the COOFIN).

568. In addition, credit rating agencies are required to disclose information to the public on the types *specified acts* and measures adopted in relation to conflict of interest management and disclosure in the explanatory documents which need to be produced on an annual basis.

569. The Guidelines further ensure that the rules on conflicts of interest are properly implemented by the credit rating agencies. Section III-2-1(6) of the Guidelines provides that the supervisory departments shall examine the following measures for preventing conflicts of interest related to the credit rating business:

- *Development of systems for identifying conflicts of interest or acts with potential conflicts of interest*
  - Whether the credit rating agency has, through appropriate means, specified and categorized in advance conflicts of interest or acts with potential conflicts of interest (*specified acts*).
  - In identifying *specified acts*, whether the credit rating agency has appropriately reflected the characteristics, size, complexity and other attributes of its business.
  - Whether the credit rating agency examines the validity and effectiveness of the *specified acts*, which it has specified and categorized, in a timely and appropriate manner, and makes revisions as necessary.
- *Measures for avoiding conflicts of interest*
  - Whether the credit rating agency has properly established *measures for avoiding conflicts of interest* consistent with the characteristics of the *specified acts* it has specified and categorized.
  - Whether the credit rating agency has developed a system wherein it can confirm, when necessary, whether there is a conflict of interest or a potential conflict of interest when conducting its credit rating activities. Whether the credit rating agency takes appropriate *measures for avoiding conflicts of interest* in cases where there is a conflict of interest or a potential conflict of interest.
  - Whether the credit rating agency examines the validity and effectiveness of its *measures for avoiding conflicts of interest* in a timely and appropriate manner, and makes revisions as necessary.
  - Whether the credit rating agency has clearly established in advance the criteria for which cases correspond to cases where "a person in charge of rating conducts a sale, purchase or other transaction of securities, etc. with a potential conflict of interest" as prescribed in Article 306(1)(vii)(A)1 of the COOFIN, and "cases where there is a potential conflict of interest between an officer or employee and a rating stakeholder" as prescribed in Article 306(1)(vii)(A) 2 of the COOFIN; and in applicable cases, whether there is a system in place to prevent officers and employees from being involved in processes relating to the determination of the credit rating. Also, whether the credit rating agency examines the validity and effectiveness of the said criteria in a timely and appropriate manner, and makes revisions as necessary.
- *Measures for publicizing, through appropriate means, the types of specified acts and an outline of its measures for avoiding conflicts of interest*.
  - Whether the credit rating agency appropriately publicizes the types of *specified acts* and an outline of its *measures for avoiding conflicts of interest*, through methods such as posting such information on its website.

How these requirements compare to those required for the objectives to be met.

570. As set out in paragraph **118** above, for the purposes of equivalence, CESR considers that overall the objectives of the individual requirements set out in paragraphs **111** to **113** above need to be met.

571. CESR considers that the objectives of the EU Regulation's conflicts of interest requirements are:

- Objectivity, independence, integrity and quality of the credit ratings

- Transparency about the credit ratings
- To contribute to the protection of investors and financial markets

Requirements of paragraph 111 above

572. These requirements involve the need for a credit rating agency to:

a) identify and eliminate or alternatively manage and disclose conflicts of interest;
b) be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities;
c) establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate or manage and disclose any conflicts of interest;
d) identify, eliminate or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgment of its ratings analysts, employees and other natural persons whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuance of credit ratings and persons approving credit ratings;
e) publicly disclose the names of the rated entities or related third parties from which it receives more than 5% of its annual revenue;
f) not issue a credit rating or in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex 1 section B paragraph 3 of the EU Regulation;
g) ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party;
h) design its reporting and communication channels so as to ensure independence of related persons from the other activities of the credit rating agency carried out on a commercial basis;
i) ensure that compensation and performance evaluation of the rating analysts' and persons approving the credit ratings are not linked to the amount of revenue they generate
j) disclose any actual and potential conflicts of interest;
k) have requirements whereby those who know of others illegal conduct report it to the compliance officer without negative consequences;
l) require that where a rating analyst terminates his or her employment and joins a rated entity, in the credit rating of which the analyst has been involved, or a financial firm, with which the rating analyst has had dealings as part of his or her duties at the credit rating agency, the credit rating agency is required to review the relevant work of the analyst preceding his departure;
m) establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

How the Japanese requirements meet the objectives of these EU requirements

a) Identify and eliminate or alternatively manage and disclose conflicts of interest; establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate or manage and disclose any conflicts of interest; and disclose any actual and potential conflicts of interest

573. The requirements referred to in paragraph **572 a)**, **c)** and **j)** above all deal with the same overall provision and as such are grouped together for the purposes of the discussion below.

574. Article 306(1)(vii)(a) of the COOFIN contains a general obligation to identify and prevent or manage potential or actual conflicts of interest by means of an operational control system which provides:

"that the following measures to prevent any Conflicts of Interest which may arise in connection with the Credit Rating Business have been implemented:

(a) the measures to ***identify*** *Credit Rating Activities which entail any actual or potential Conflicts of Interest (hereinafter referred to as "Specified Acts" in this Chapter) by an appropriate method, and to* ***secure*** *that such acts would* ***not adversely affect*** *the interest of investors (including the following measures; hereinafter referred to as the "Measures for* ***Preventing*** *Conflicts of Interest" in this Chapter) […]".*

575. Article 306(1)(vii)(b) of the COOFIN requires credit rating agencies to implement operational control systems to disclose ("measures to announce") the actual or potential conflicts of interest (*Specified Acts*) which a credit rating agency has identified, and an outline of the measures for preventing conflicts of interest in an appropriate manner.

576. The Guidelines provide additional details about how credit rating agencies have to in practice meet these requirements, as discussed in paragraph **567** above.

577. A credit rating agency needs to also provide information to the JFSA during the registration process regarding the Specified Acts and the measures it will implement to prevent and disclose these Specified Acts to the public, as set out in paragraph **567** above.

578. Article 306(1)(vii)(a)(3) of the COOFIN provides for a non-exhaustive list of *measures to prevent conflicts of interest* arising to a credit rating agency:

Preventing credit rating agencies from undermining the interests of investors in the process of determining a credit rating of any *matter in which rating stakeholder*s have an interest (as defined in Article 309 COOFIN), in cases where there are any potential conflicts of interest between the credit rating agency and the relevant *rating stakeholder*, as well as in any of the following cases:

- where the credit rating agency has been furnished with loans (including the guarantee of obligations and the offering of collaterals) by a *rating stakeholder*;
- where the holder of five percent or more of the voting rights held by all the shareholders of the credit rating agency falls under the category of a *rating stakeholder*;
- where the *rating stakeholder* acts as the underwriter of securities issued by the credit rating agency;
- where the credit rating agency has been furnished by the *rating stakeholder* with a large amount of money or any other property benefit, as a consideration of services other than the services pertaining to credit rating activities.

579. Article 66-39 of the Act and Article 318(1)(iii)(e) of the COOFIN provide for a specific disclosure requirement with respect to measures to identify and prevent or manage conflicts of interest:

"A Credit Rating Agency shall, for each business year, prepare explanatory documents containing the matters specified by Cabinet Office Ordinance as the matters concerning status of business [i.e.: the types of Specified Acts and an outline of Measures for Avoiding Conflict of Interest; Article 318(1)(iii)(e) of the COOFIN]*, and keep the said explanatory documents at all of its business offices or offices and make them available for public inspection, as well as publicizing them via the Internet or by any other method pursuant to the provisions of Cabinet Office Ordinance, for one year from the day on which the period specified by Cabinet Order has elapsed after the end of each business year."*

Box 10

Identify and eliminate or alternatively manage and disclose conflicts of interest; establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate or manage and disclose any conflicts of interest; and disclose any actual and potential conflicts of interest

580. There are specific and detailed requirements obliging a credit rating agency to identify, prevent, manage and disclose any actual or potential conflicts of interest ("Specified Acts"), as well as Guidelines which further explain how these requirements are expected to be met in practice.

581. On this basis, CESR considers that the objectives of these EU requirements are met.

b) Be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities

582. Annex I, Section A.2 of the EU Regulation requires a credit rating agency to be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities.

583. CESR points out that there are requirements that deal with this provision. Articles 66-32 and 66-33 of the Act as well as Article 306(1)(vii) of the COOFIN oblige credit rating agencies to implement all necessary measures to prevent any conflicts of interest which may arise in connection with the credit rating business:

Article 66-32 of the Act:

"A Credit Rating Agency as well as Officers and employees thereof shall execute their business in good faith and fairly from an independent standpoint)".

Article 66-33 of the Act:

"(1) A Credit Rating Agency shall establish operational control systems for the fair and appropriate performance of its Credit Rating Business, pursuant to the provisions of Cabinet Office Ordinance in order to conduct its Credit Rating Business with fairness and adequacy.

(2) The operational control systems referred to in the preceding paragraph shall include measures to maintain the quality of the business such as assigning persons with expert knowledge and skills, measures to prevent the undermining of the investors' interests for the purposes of pursuing its own interest or the interest of a Rating Stakeholders (meaning person specified by Cabinet Office Ordinance as those who have interest with regard to the matters subject to the Credit Ratings; the same shall apply in Article 66-35) and any other measures for ensuring fairness in the business operation."

Article 306(1) of the COOFIN:

"The operational control systems required to be established by a Credit Rating Agency pursuant to the provision of Article 66-33, paragraph (1) of the Act shall satisfy the following requirements:

Article 306(1)(vii) of the COOFIN:

"(vii) that the following measures to prevent any Conflicts of Interest which may arise in connection with the Credit Rating Business have been implemented:

(a) the measures to identify Credit Rating Activities which entail any actual or potential Conflicts of Interest (hereinafter referred to as "Specified Acts" in this Chapter) by an appropriate method, and to secure that such acts would not adversely affect the interest of investors (including the following measures; hereinafter referred to as the " Measures for Preventing Conflicts of Interest" in this Chapter):
1. the measures to prevent Person in Charge of Rating from conducting any Sales and Purchases or Other Transactions of Securities, etc. which may entail any Conflicts of Interest;
2. the measures to prevent any Officer or employee who has any potential Conflicts of Interest with a Rating Stakeholder, if any, from participating in the process of determining the Credit Rating of any matter in which said Rating Stakeholder has an interest;
3. the measures to ensure that the Credit Rating Agency would not undermine the interests of investors in the process of determining a Credit Rating of any Matter in Which Rating Stakeholders Have Interests, in cases where there are any potential Conflicts of Interest between the Credit Rating Agency and the relevant Rating Stakeholder, and in cases where any of the following applies:
(i) where the Credit Rating Agency has been furnished with loans (including the guarantee of obligations and the offering of collaterals) by Rating Stakeholder;
(ii) where the holder of five percent or more of the Voting Rights Held by All the Shareholders, etc. of the Credit Rating Agency (excluding voting rights set forth in Article 16) falls under the category of a Rating Stakeholder;
(iii) where the Rating Stakeholder acts as the underwriter of Securities issued by the Credit Rating Agency; or
(iv) where the Credit Rating Agency has been furnished by the Rating Stakeholder with a large amount of money or any other property benefit, as a consideration of services other than the services pertaining to Credit Rating Activities;
4. the measures to prevent Person in Charge of Rating from making any approach in an attempt to assume the position of an Officer or any other position equivalent thereto of the Rating Stakeholder;
5. the measures to be implemented so as to verify the appropriateness of a Credit Rating of any Matter in Which Rating Stakeholder Has an Interest, in cases where any Rating Analyst who no longer assumes the position of Officer or employee of the Credit Rating Agency has assumed the position of an Officer or any other position equivalent thereto of such Rating Stakeholder (limited to the cases where such former Rating Analyst participated in the process of determining such Credit Rating within two years prior to the day when he/she ceased to be an Officer or employee of the Credit Rating Agency);
(b) the measures to announce the types of Specified Acts and the outline of Measures for Preventing Conflicts of Interest, in an appropriate manner."

Box 11

Be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities

584. CESR is comfortable that the objective of this requirement is met through the general obligation for a credit rating agency (i) to perform business fairly and independently, and (ii) to implement measures in order to identify, prevent, manage and disclose conflicts of interest.

c) Identify, eliminate or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgment of its ratings analysts, employees and other natural persons whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuance of credit ratings and persons approving credit ratings

585. The following paragraphs relate to the EU requirement set out in paragraph **572 d)** above.

586. As set out in paragraphs **574** and **575** above, Article 306(1)(vii)(a) and (b) of the COOFIN contain general obligations to identify and prevent or manage and disclose actual and potential conflicts of interest by means of an operational control system.

587. Additionally, Article 306(1)(vii)(a)(1) and (2) of the COOFIN provide for specific measures (*measures for preventing conflicts of interest*) addressing the prevention of potential conflicts of interest on the employee level, which are to be implemented by credit rating agencies, aiming at:

- preventing personal trading of persons in charge of rating which may entail conflicts of interest;
- preventing participation of employees having potential conflicts of interest with *rating stakeholder*s (definition in Article 307 of the COOFIN) in the rating determination process.

588. Furthermore and pursuing the same goal, there is a prohibition concerning the participation of persons in charge of ratings in fee negotiations (see paragraph **685** below).

Box 12

Identify, eliminate or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgment of its ratings analysts, employees and other natural persons whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuance of credit ratings and persons approving credit ratings

589. The Japanese framework contains specific requirements obliging a credit rating agency to ensure that conflicts of interest that may influence the judgements of individuals involved in the credit rating activities are identified, prevented, managed and disclosed.

590. On this basis, CESR considers that the objective of this EU requirement is met.

d) Publicly disclose the names of the rated entities or related thirds parties from which it receives more than 5% of its revenue

591. The discussion below relates to the EU requirement set out in paragraph **572 e)** above

592. Annex I, Section B.2 of the EU Regulation requires a credit rating agency to publicly disclose the names of the rated entities or related third parties from which it receives more than 5% of its annual revenue.

593. As explained in paragraph 119 above this information does not have to be disclosed to the public for the purposes of assessing equivalence provided that there is some disclosure to the supervisor.

594. As indicated in the answer to Q11 (b), the Japanese legislation provides for the public disclosure of the names of all *rating stakeholder*s from which the credit rating agency receives rating fees exceeding 10% of the sales volume of the credit rating business (Article 66-39 of the Act and Article 318(1)(ii)(b)(2) of the COOFIN). CESR understands that the term 'revenue' as used in the EU Regulation is broadly covering the same as the term 'sales volume' in the COOFIN.

595. In addition, under Article 315(1)(ii) of the COOFIN, a credit rating agency is required to maintain, and make available to the JFSA, records on any rating stakeholder who paid fees to it, including the name of the rating stakeholder, the amount of the fees and the services provided.

Box 13

Publicly disclose the names of the rated entities or related thirds parties from which it receives more than 5% of its revenue

596. A credit rating agency needs to publicly disclose the names of the rated entities from which it receives more than 10% of its annual revenue.

597. CESR concludes that, although the Japanese rules set a different threshold for the disclosure (10% instead of 5% in the EU Regulation), the overall objective of this requirement is met.

e) Not issue a credit rating or in the case of an existing credit rating immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex 1 section B paragraph 3 of the EU Regulation.

598. The discussion below relates to the EU requirement set out in paragraph **572 f)** above.

599. Annex I, Section B.3 of the EU Regulation provides for a list of circumstances where a credit rating agency shall not issue a credit rating or shall, in the case of an existing credit rating, immediately disclose where the credit rating is potentially affected as follows:

a) the credit rating agency or related persons directly or indirectly, owns financial instruments of the rated entity or any related third party or has any other direct or indirect ownership interest in that entity or party other than holdings in diversified collective investment schemes or managed funds including pension funds and life insurance,
b) the credit rating is issued with respect to a rated entity or any related third party directly or indirectly linked to the credit rating agency by control,
c) a related person is a member of the administrative or supervisory boards of the rated entity or any related third party,
d) an analyst who participated in determining a credit rating, or a person who approved a credit rating, has had any relationship with the rated entity or any related third party thereof, which may potentially cause a conflict of interest.

600. In Japan all these requirements are covered by a combination of the following provisions: (i) Article 66-35(i) of the Act, which sets out the prohibition on a credit rating agency or its officers and employees to provide a credit rating in relation to a rated entity where there is some form of "close relationship" between them; (ii) Article 308 of COOFIN, which sets out the nature of the "close relationships" that are prohibited in Article 66-35(1) of the Act, (iii) Article 309 of COOFIN, which sets out the nature of the interests by the rating stakeholders in the credit rating; (iv) Article 306(1)(vii)(a) and (b) of the COOFIN, which imposes the obligation to implement measures to identify, prevent, manage and disclose potential or actual conflicts of interest.

601. More specifically, the requirements in paragraph **599a)** above is met through the provisions of Article 66-35(i) of the Act and Articles 306(1)(vii)(a)(1), 308(1)(iii) and (iv) and 308(2) of the COOFIN.

602. According to Article 66-35(i) of the Act:

"A Credit Rating Agency or the Officers or employees thereof shall not conduct any of the following acts with regard to their Credit Rating Business:(i) in cases where the Credit Rating Agency or the Officers or employees thereof have a close relationship specified by Cabinet Office Ordinance with a Rating Stakeholder, an act of providing to someone or making available to the public, Credit Ratings on matters specified by Cabinet Office Ordinance as those in which the said rating stakeholders has interests".

603. According to Article 308(1)(iii) and (iv) of the COOFIN the ownership of securities of the rated entity by the credit rating agency or by any of its rating analysts or members of the rating committee (including under any other person's name) qualifies as a "close relationship" for the purposes of the aforesaid Article 66-35 of the Act and therefore is prohibited.

604. Namely, Articles 308(1), Article 308(1) (iii) and (iv) of the COOFIN states that:

Article 308(1) of the COOFIN

"(1) The close relationship specified by Cabinet Office Ordinance, as referred to in Article 66-35, item (i) of the Act, shall be the relationship between the Credit Rating Agency or its Officers or employees, and the Rating Stakeholders, in cases where any of the following situations applies:"

Articles 308(1)(iii) and (iv) of the COOFIN

"(iii) where the Credit Rating Agency or its Person in Charge of Rating is a holder of Securities (excluding Securities as set forth in Article 2, paragraph (1), item (i) and item (ii) of the Act and Securities as set forth in item (xvii) of that paragraph (limited to Securities which have the nature listed in item (i) and item (ii) of that paragraph) issued by the Rating Stakeholder;
or (iv) where the Credit Rating Agency or its Person in Charge of Rating is a person entitled to any rights related to Derivatives Transactions (limited to Derivative Transactions related to the Rating Stakeholders or Securities issued by the Rating Stakeholders)". [32]

605. The *matters in which the said rating stakeholders has interests* are defined in Article 309 of the COOFIN as follows:

"The matters specified by Cabinet Office Ordinance, as referred to in Article 66-35, item (i) of the Act shall be as follows:
(i) the assessment of the credit status of the Rating Stakeholder;
(ii) the assessment of the credit status of financial instruments, in cases where the Rating Stakeholder is an issuer (limited to the case where said financial instruments are Securities) or obligor (limited to the case where said financial instruments are loan claims) of said financial instruments; and
(iii) the assessment of the credit status of financial instruments or juridical persons pertaining to certain structures, in cases where the Rating Stakeholder is the consignee of business affairs related to such structures."

606. Article 306(1)(vii)(a)(1) of the COOFIN imposes an obligation on the credit rating agency to adopt measures to prevent a person in charge of rating from conducting any sales and purchases or other transactions of securities which may entail conflicts of interest.

607. CESR understands following additional clarification on this point from the staff of the JFSA, that in case of existing credit ratings, the ownership of financial instruments of the rated entity by the credit rating agency, its rating analysts or members of the rating committee is a prohibited act therefore the credit rating agency would not be able to update the credit rating and would have to either withdraw the credit rating or sell the financial instruments.

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32 Note that Article 308(2) of the COOFIN further explains who the holder in Article 308(1)(iii) and (iv) of the COOFIN includes.

608. The requirement in paragraph **599b)** above, which prohibits a credit rating agency to issue a credit rating in respect of a rated entity linked to the credit rating agency by control, is covered:

a) in the case where the credit rating agency controls the rated entity, by the prohibition set out in Article 66-35(i) of the Act and Articles 308(1)(iii) and 308(2) of the COOFIN discussed in paragraphs **602** to **607** above;

b) in the case where the credit rating agency is controlled by the rated entity, by the provisions of Article 306(1)(vii)(a)(3)(ii) of the COOFIN, which require a credit rating agency to implement measures to avoid conflicts of interest where the holder of 5% of more of the voting rights held by all the shareholders of the credit rating agency falls under the category of a rating stakeholder[33].

609. CESR understands following additional clarification on this point from the staff of the JFSA, that in case of existing credit ratings, the control by the rated entity over the credit rating agency needs to be disclosed as a Specified Act in the case that the rated entity holds 5% or more of the voting rights of the credit rating agency. In the case that the rated entity holds less than 5% of the voting rights of the credit rating agency this might pose a conflict of interest and is disclosable as a Specified Act, where the credit rating agency considers that such ownership gives rise to a conflict of interest.

610. The requirement in paragraph **599c) above**, which prohibits a credit rating agency to issue a credit rating when a related person is a member of the administrative or supervisory boards of the rated entity or any related third party, is covered by the prohibitions set out in Article 66-35(1) of the Act and Articles 308(1)(i)(ii) and (iii) and 309 of the COOFIN.

611. These provisions prohibit a credit rating agency to issue credit ratings where the credit rating agency or its employees have a close relationship with a *rating stakeholder*, including where the rating analysts or a member of the rating committee (or a relative of them) is the officer of the rated entity (see paragraph **635** below for details of this).

612. The requirement in paragraph **599d) above** which prohibits a credit rating agency to issue a credit rating where an analyst who participated in determining a credit rating, or a person who approved a credit rating, has had any relationship with the rated entity or any related third party thereof, which may potentially cause a conflict of interest – is covered by the provisions of Article 308 of COOFIN as well as by Article 306(1)(vii)(a)(2) of the COOFIN.

613. Article 306(1)(vii)(a)(2) of the COOFIN requires a credit rating agency to implement, as part of its operational control systems, measures in order to prevent any officer or employee from participating in the determination of a credit rating where such persons have any potential conflict of interest with the *rating stakeholder*.

Box 14

Not issue a credit rating or in the case of an existing credit rating immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex I(B)(3) of the EU Regulation

[33] In addition according to Article 306(1)(vii)(b) of the COOFIN a credit rating agency has to disclose this type of conflict as a Specified Act as well as an outline of the measures to prevent it.

614. CESR considers that overall the objective of this EU requirement is met through the interaction of the provisions that: (i) set out the prohibition on a credit rating agency or its officers and employees to provide a credit rating in relation to a rated entity where there is some form of "close relationship" between them; (ii) specify the nature of the "close relationships" that are prohibited, (iii) set out the nature of the interests by the rated entity in the credit rating; (iv) impose an obligation to implement measures to identify, prevent, manage and disclose potential or actual conflicts of interest.

(f) Ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party

615. The discussion below relates to the EU requirement set out in paragraph **572 g)** above.

616. Article 306(1)(viii) of the COOFIN provides that measures need to be implemented so that activities pertaining to ancillary business or other lines of business would not unreasonably affect the credit rating activities.

617. CESR points out that, like in the EU, in Japan, credit rating agencies need to make sure that there is no conflict of interest between the provision of ancillary services and the issuance of credit ratings.

618. Unlike in the EU, in Japan there is no requirement for credit rating agencies to disclose in rating reports ancillary services provided for the rated entity or any other related third party. However, there is a disclosure, during the registration phase[34] as well as an on-going basis (in the business report to the JFSA[35] and the explanatory documents made available to the public[36]), on the type and status of the ancillary services performed by the credit rating agency.

619. In addition, there is a disclosure requirement about the measures implemented to avoid conflicts of interest between credit rating activities and ancillary services both to the JFSA as part of the application process,[37] and to the public as part of the annual explanatory documents.[38]

620. In addition, Article 306(1)(vii)(a)(3)(iv) of the COOFIN provides that a credit rating agency needs to implement, as part of its operational control systems, measures in order to avoid conflicts of interest where it has received a large amount of money by the *rating stakeholder* as a consideration for services other than credit rating activities.

621. Section III-2-1 (7) of the Guidelines set out additional detail on the measures to prevent acts pertaining to ancillary services from having an "undue influence" on credit rating activities.

"(i) Whether the credit rating agency, having first clarified its own ancillary business and other business operations, has specified and categorized in advance, through appropriate means, any acts pertaining to these business operations which have the potential to have an undue influence on its credit rating activities.
(ii) Whether the credit rating agency has, consistent with the characteristics of the acts it

34 Article 66-28(1)and(iv) of the Act.
35 Article 66-38 of the Act and Article 316 of the COOFIN.
36 Article 318(1)(ii)(b)(5) of the COOFIN.
37 Article 299(xxviii) of the COOFIN.
38 Article 318(1)(iii)(g) of the COOFIN.

has specified and categorized, taken appropriate measures to prevent such acts from having an undue influence on its credit rating activities, for instance, by conducting management based on the separation of divisions. Also, whether the credit rating agency examines the validity and effectiveness of the said measures in a timely and appropriate manner, and makes revisions as necessary."

Box 15

Ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party

622. There are extensive and detailed provisions aimed at avoiding conflicts of interest between the performance of ancillary services and credit rating activities, accompanied by disclosure obligations concerning the type and status of ancillary services.

623. Unlike in the EU, in Japan there is no requirement for credit rating agencies to disclose in rating reports ancillary services provided for the rated entity or any other related third party. However, there is a disclosure, during the registration phase to the JFSA as well as an on-going basis in the business report to the JFSA and the explanatory documents made available to the public.

624. CESR concludes that the objectives of these EU provisions are met.

g) Design its reporting and communication channels so as to ensure independence of related persons from the other activities of the credit rating agency carried out on a commercial basis

625. The discussion below relates to the EU requirement set out in paragraph **572 h)** above.

626. Article 306(1)(i) of the COOFIN provides that:

"(1) The operational control systems required to be established by a Credit Rating Agency pursuant to the provision of Article 66-33, paragraph (1) of the Act shall satisfy the following requirements: (i) that measures have been implemented so that the Credit Rating Agency shall always maintain a fair and unbiased stance in order to perform its Credit Rating Activities at its sole judgment and responsibility".

627. The operational control systems needs to also ensure that persons involved in the determination of credit ratings do not take part in the negotiations of the relevant fees (Article 306(1)(xi) of the COOFIN), as detailed in paragraphs **685** to **690** below.

628. In addition, a credit rating agency is required to implement operational control systems in order to ensure that there is no conflicts of interest between the credit rating activities and the ancillary services as discussed in detail in paragraphs **615** to **617** above.

629. As general as this rule is, it can be interpreted as requiring credit rating agencies inter alia to design communication channels so as to ensure independence of related persons from the other activities of the credit rating agency carried out on a commercial basis.

Box 16

Design its reporting and communication channels so as to ensure independence of related persons from the other activities of the credit rating agency carried out on a commercial basis

630. A credit rating agency is required to implement operational control systems in order to ensure that credit rating activities are carried out fairly and objectively, that no conflicts of interest arise between these activities and the ancillary services it carries out, and that persons in charge of ratings are prevented from participating in the negotiations of the relevant fees.

631. CESR understands that these operational control systems require the establishment of appropriate reporting and communication channels to ensure independence of persons involved in the determination of the credit rating business.

632. On this basis, CESR considers that the objective of this EU requirement is met.

h) Ensure that compensation and performance evaluation of the rating analysts and persons approving the credit ratings are not linked to the amount of revenue they generate

633. The discussion below relates to the EU requirement set out in paragraph **572 i)** above.

634. Articles 306(1)(x)(b) of the COOFIN provides that a credit rating agency shall implement operational control systems ensuring:

> *"(x) that the measures have been implemented so as to formulate the policy for the determination of the Remuneration, etc. (meaning any remuneration, bonus or any other property benefit payable by the Credit Rating Agency as a consideration for the performance of duties; hereinafter the same shall apply in this Chapter) of the Officers or employees of the Credit Rating Agency (limited to a policy which contains the following details), and so as to ensure that such policy would not adversely affect the performance of the Credit Rating Business in a fair and adequate manner (including measures pertaining to the establishment of a system for periodically performing a review of such policy):*
> *(b) that the amount of the Remuneration, etc. payable to Person in Charge of Ratings would not be affected by the amount of the Rating Fee (meaning the value of the money or any other property which has been paid or is to be to the Credit Rating Agency as a consideration for determining a Credit Rating; hereinafter the same shall apply in this Chapter) for the Credit Rating."*

635. According to Article 295(3)(v) of the COOFIN, "Person in Charge of Rating" means both rating analysts and members of the rating committee.

636. Details of the measures implemented in accordance with Article 306(1)(x)(b) of the COOFIN above need to be provided to the JFSA as part of the registration process[39], as well as disclosed to the public in the explanatory documents to be prepared on an annual basis[40].

39 Article 299(xxxi) of the COOFIN.
40 Article 318(1)(iii)(i) of the COOFIN.

Box 17

Ensure that compensation and performance evaluation of the rating analysts and persons approving the credit ratings are not linked to the amount of revenue they generate

637. A credit rating agency needs, as part of its operational control systems, to implement measures ensuring that the remuneration of rating analysts and members of rating committee is not affected by the amount of the consideration received for determining the credit rating.

638. On this basis, CESR considers that the objective of this EU requirement is met.

(i) Have requirements whereby those who know of others illegal conduct report it to the compliance officer without negative consequences

639. The discussion below relates to the EU requirement set out in paragraph **572 k)** above.

640. Japan does have a specific requirement that deals with this.

641. Article 306(1)(v)(c)(3) of the COOFIN requires that operational control systems of credit rating agencies provide for:

> *"measures to ensure that the person who has made the notification [an illegal act of an employee] shall not be treated unfavourably on account of having made such notification".*

642. Section III-2-1 (4)(ii) of the Guidelines says that supervisory departments shall examine how credit rating agencies have developed their operational control systems by taking the following into consideration:

> *"(a) Whether the credit rating agency has clearly designated the division in charge of the whistle-blowing system and established specific procedures for handling internal allegations, so as to ensure that they are processed and a response is made in a prompt and appropriate manner.*
> *(b) Whether the credit rating agency has developed a system wherein information on the content of internal allegations can be shared within a necessary and appropriate scope.*
> *(c) Whether the credit rating agency makes sure to properly follow up on how internal allegations are being handled.*
> *(d) Whether the credit rating agency accurately and appropriately records and stores the details of internal allegations and the results of investigations thereof, and whether it makes full use of this information such as to improve its operational control system and to formulate measures for preventing a recurrence".*

Box 18

Have requirements whereby those who know of others illegal conduct report it to the compliance officer without negative consequences

643. There is a specific requirement for a credit rating agency to implement measures to ensure that illegal conducts may be reported without negative consequences.

644. CESR concludes that the objectives of this provision are met.

(j) Require that when a rating analyst terminates his or her employment and joins a rated entity there is a review of the relevant work of that analyst

645. The discussion below relates to the EU requirement set out in paragraph **572 l)** above

646. Annex I, Section C.6 of the EU Regulation requires that, where a rating analyst terminates his or her employment and joins a rated entity, in the credit rating of which the analyst has been involved, or a financial firm, with which the rating analyst has had dealings as part of his or her duties at the credit rating agency, the credit rating agency is required to review the relevant work of the analyst preceding his/her departure over two years preceding his/her departure.

647. The Japanese legislation contains rules on this issue.

648. Article 306(1)(vii)(a)(5) of the COOFIN requires credit rating agencies to implement measures:

> *"so as to verify the appropriateness of a Credit Rating of any Matter in Which Rating Stakeholder Has an Interest, in cases where any Rating Analyst who no longer assumes the position of Officer or employee of the Credit Rating Agency has assumed the position of an Officer or any other position equivalent thereto of such Rating Stakeholder (limited to the cases where such former Rating Analyst participated in the process of determining such Credit Rating within two years prior to the day when he/she ceased to be an Officer or employee of the Credit Rating Agency)".*

649. Information on these measures needs to be disclosed to the JFSA as part of the registration process[41] and to the public as part of the annual obligation to provide explanatory documents[42].

Box 19

<u>Require that when a rating analyst terminates his or her employment and joins a rated entity there is a review of the relevant work of that analyst</u>

650. There is an explicit requirement for a credit rating agency to verify ratings after a former rating analyst has assumed an employment with a rated entity or a financial firm with which he or she has had dealings as part of his or her duties at the credit rating agency. In addition, there are disclosure requirements to both the JFSA and the public regarding this matter.

651. CESR therefore considers the objectives of the requirement are met.

k) establish an appropriate gradual rotation mechanism

652. The discussion below relates to the EU requirement set out in paragraph **572 m)** above.

653. Article 7.4 of the EU Regulation provides that credit rating agencies are required to establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

654. The Japanese legislation contains rules on this issue.

41 Article 299(xxvi) of the COOFIN.
42 Article 318(1)(iii)(f) of the COOFIN.

655. Article 306(1)(ii)(a) and (b) of the COOFIN provides that a credit rating agency needs to establish operational control systems ensuring:

"(ii) that any of the following measures has been implemented, so that a Person in Charge of Rating, as a party independent from Rating Stakeholders, fairly and faithfully carries out the business, in cases where such Person in Charge of Rating participates consecutively in the processes of determining Credit Ratings of the matters in which the same Rating Stakeholder has an interest;
(a) measures to be implemented so that, in cases where any Lead Rating Analyst participating in the process of determining a Credit Rating had, for five consecutive years, participated in the process of determining a Credit Rating of the matter in which the same Rating Stakeholder has an interest, such Lead Rating Analyst would refrain from participating in the process of determining a Credit Rating of the matter in which the same Rating Stakeholder has an interest for two subsequent years thereafter;

(b) measures to ensure that the final decision as a Credit Rating Agency in determining a Credit Rating shall be made by a resolution of the council; and measures so that one third or more of the total of the council members would not participate consecutively in the processes of determining Credit Ratings for the matter in which the same Rating Stakeholders has an interest (in cases where the object of the Credit Rating is the assessment of the credit status of any subject other than Asset Securitization Products, and where two or more Credit Ratings with the same object were determined in the same business year, such two or more Credit Ratings shall be deemed to be a single Credit Rating)".

656. Section III-2-1 (1)(i) of the Guidelines provides that supervisory departments shall examine how credit rating agencies have developed their operational control systems by taking the following into account:

"(1) Measures pertaining to instances where a person in charge of rating is consecutively involved in processes relating to the determination of a credit rating on a matter in which the same rating stakeholder has an interest (rotation rule)
(i) Whether the credit rating agency has clearly established in advance whether it will use both or select one of either of the measures prescribed in Article 306(1)(ii)(A) or (B) of the FIB Cabinet Office Ordinance [COOFIN] (and the application criteria of each measure in cases where it uses both)."

657. Thus the Japanese system offers two alternatives. Either lead analysts' terms are limited to five years maximum followed by a two years break. As can be seen, in option 1 (Article 306(1)(ii)(a) of the COOFIN) a rotation requirement does only exist for lead rating analysts, but not for all other rating analysts and those persons approving credit ratings, as it is the case in the EU (Annex I, Section C.8 of the EU Regulation). Or there is a rating council within which the rotation of one third or more of the members in charge of finally deciding on a credit rating needs to happen from one decision to the consecutive one at the end of each business year for corporate bonds rating, if the same *rating stakeholder* has an interest; in case of structured finance the change needs to happen each time if the combination of issuer arranger and originator is the same.

658. Information on the measures implemented to comply with the Japanese rotation requirements needs to be disclosed to the JFSA as part of the registration process[43] and to the public as part of the annual obligation to provide explanatory documents[44].

659. As discussed in paragraphs **467** to **480** above, in certain limited circumstance, the Commissioner of the JFSA may approve an exemption from these requirements under Article 306(2) and 306(6) of the COOFIN, provided, among other things, that appropriate alternative measures are implemented.

43 Article 299(v) of the COOFIN.
44 Article 318(1)(iii)(a) of the COOFIN.

Box 20

Establishing a gradual rotation mechanism

660. The Japanese framework does include a specific requirement to implement a rotation mechanism, allowing credit rating agencies to decide between two possible ways of implementing the provision, which goes in line with the Japanese pragmatic approach to the need to tailor the requirements to the specific size and complexity of the credit rating agency.

661. Although option 1 of the Japanese rotation regime applies only to lead analysts, but not to all other rating analysts or persons approving credit ratings, CESR is satisfied that this rule does meet the objectives of the EU Regulation. The same applies to option 2 of the Japanese rotation regime which, on the one side, only provides for the rotation of a third of the members of a rating council and which, to this end, is less strict than the rotation of 100% of the persons involved, but which, on the other hand, needs to be effected already after one participation in a rating council decision only if the same *rating stakeholder* has an interest, instead of every five years as provided in the EU Regulation for lead analysts.

662. Irrespective of the fact that an exemption in relation to the rotation requirement can be granted in very limited circumstances, CESR is satisfied that the objectives of this requirement are met.

Requirements of paragraph 112 above

663. There are three requirements in paragraph 112:

a) a credit rating agency is prohibited from providing consultancy or advisory services ; and
b) credit rating analysts or persons approving ratings are prohibited from making proposals or recommendations on the design of structured finance products about which the credit rating agency is expected to issue a rating;
c) credit rating analysts are prohibited from being involved in the negotiation of fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.

a) A credit rating agency is prohibited from providing consultancy or advisory services

664. In order to avoid potential conflicts of interest from the issuing of credit ratings, Annex I, Section B.4 of the EU Regulation states that credit rating agencies are prohibited from providing consultancy or advisory services to the rated entity or a related third party regarding the corporate or legal structure, assets, liabilities or activities of that rated entity or related third party".

665. In Japan, Article 66-35(ii) of the Act prohibits the "*act of providing to someone or making available to the public […] Credit Ratings":*

"in cases where the Credit Rating Agency or the Officers or employees thereof have given advice to a rating stakeholder on matters specified by Cabinet Office Ordinance as those that may have material influence on the Credit Rating related to the said Rating Stakeholder (excluding cases where the Credit Rating Agency or the Officers or employees thereof have provided the details of the Rating Policy, etc. as defined in paragraph (1) of the following Article [Article 66-36(1)] in response to

the request from the said rating stakeholder or other cases specified by Cabinet Office Ordinance as being less likely to result in insufficient protection of investors in light of the manner of advice)".

666. The matters specified by the COOFIN as those that may have material influence on the credit rating related to the *rating stakeholder* to which reference is made in Article 66-35(ii) of the Act are defined in Article 310 of the COOFIN as follows:

"(i) the organizational scheme of the juridical person and the composition of the principal assets and liabilities thereof, in cases where the object of the Credit Rating is the assessment of the credit status of such juridical person or Securities issued by such juridical person; and
(ii) material matter on the structures of financial instruments or the structures of claim pertaining to a monetary loan held against a juridical person, in cases where the object of the Credit Rating is the assessment of such financial instruments or juridical person".

667. The cases specified by Article 311 of the COOFIN as being less likely to result in insufficient protection of investors in light of the manner of advice, as referred to in Article 66-35(ii) Act, are cases where the credit rating agency:

"in response to a request from the Rating Stakeholder, has provided an explanation as to how the information or facts provided by the Rating Stakeholder may affect the determination of Credit Rating, in accordance with the Rating Determination Policy, etc. and any matter incidental thereto".

668. In addition, Section III-2-2 (2) of the Guidelines provides the following:

"From the perspective of ensuring the fairness of the rating process, ensuring the independence of credit rating agencies and avoiding conflicts of interest, Article 66-35(ii) of the Act prohibits credit rating agencies and their officers and employees from engaging in acts of providing or making available for inspection a credit rating in cases where they have provided advice to a rating stakeholder on a matter that could be expected to have a material influence on the said credit rating related to the said rating stakeholder. At the same time, in order to prevent appropriate business communication between credit rating agencies and rating stakeholders from being impeded, pursuant to the provisions of Article 311 of the FIB Cabinet Office Ordinance, credit rating agencies are permitted, at the request of a rating stakeholder, to provide an explanation on the effects that information or facts provided by the rating stakeholder would have on the determination of the credit rating, based on the agency's rating determination policy, etc. and on matters related to this. In view of these points, it is important for credit rating agencies to establish operational control systems whereby they can appropriately keep track of the progress of negotiations with rating stakeholders. As such, supervisory departments shall conduct examinations by taking the following points, for instance, into consideration.

(i) Scope of advice pertaining to matters having a material influence on a credit rating Whether the credit rating agency has clarified in its internal rules, etc. the scope of advice that is prohibited. In this case, whether the credit rating agency has promoted full communication to, and understanding among, its officers and employees, such as by presenting specific cases of advice which could be in contravention of the prohibition.

(ii) Keeping track of the progress of negotiations with rating stakeholders

(a) With regard to records related to the progress of negotiations with rating stakeholders, in addition to properly establishing in its internal rules, etc. the items to be listed, whether the credit rating agency has fully communicated these to its officers and employees.

(b) Whether the legal compliance division or the internal audit division strives to keep track of the progress of negotiations with rating stakeholders, and whether it examines if negotiations are being conducted appropriately; and whether it strives to establish systems for ensuring the effectiveness thereof, such as by revising the internal rules, etc. when necessary".

669. Thus in Japan and the EU, credit rating agencies are prevented from issuing credit ratings on:
- an entity or a related third party (EU) /
- a *rating stakeholder* (Japan)

and, at the same time, providing consultancy services with respect to:

- the corporate or legal structure,
- assets,
- liabilities and
- activities of that rated entity or related third party (EU) /
- the organizational scheme of the juridical person,
- the composition of the principal assets
- the composition of the principal liabilities thereof (Japan).

670. CESR understands following clarification of this issue from the staff of the JFSA that the definition of "*rating stakeholder*" in Article 307 of the COOFIN does include the concept of "related third party" as set out in Article 3(1)(i) of the EU Regulation, and therefore that both in Japan and the EU, credit rating agencies are prevented from issuing credit ratings and at the same time providing consultancy services to the rated entity or related third parties with respect to their structure, assets and liabilities.

671. As can be seen, the Japanese and the EU requirements are similar.

672. According to Article 318(1)(ii)(b)(1) and (5) of the COOFIN, a credit rating agency is required to provide information on the status of the lines of business different from the credit rating activities in the explanatory documents to be prepared and published on an annual basis, and on the proportion of its revenue deriving from such other lines of business.

673. In addition, a credit rating agency is required to implement[45], and disclose during the registration process and on an annual basis information on, the measures set out to ensure compliance with the laws and regulations[46]. CESR understands that these measures should include procedures to deal with the prohibition to provide consultancy services as discussed above.

Box 21

Prohibition to provide consultancy or advisory services

674. Credit rating agencies are expressly prohibited from providing consultancy services to the rated entity and also in CESR's understanding to related third parties regarding their organisation or assets and liabilities.

675. CESR therefore considers that the objectives of the EU requirement are met.

45 Article 306(1)(v)(a) of the COOFIN.
46 Article 299(ix) and(xiii) and Article 318(1)(iii)(c) of the COOFIN.

b) Credit rating analysts or persons approving ratings are prohibited from making proposals or recommendations on the design of structured finance products about which the credit rating agency is expected to issue a rating

676. According to Annex I, Section B.5 of the EU Regulation,

> *"a credit rating agency shall ensure that rating analysts or persons who approve ratings do not make proposals or recommendations, either formally or informally, regarding the design of structured finance instruments on which the credit rating agency is expected to issue a credit rating."*

677. In Japan, this requirement is covered by the provisions of Article 66-35(ii) of the Act and Article 310(ii) of the COOFIN.

678. As indicated in paragraph **665** above, Article 66-35(ii) of the Act prohibits a credit rating agency from determining a credit rating where the credit rating agency itself or its officers or employees have given advice to the *rating stakeholder* on matters specified by a Cabinet Office Ordinance as those that may have material influence on the credit rating related to such *rating stakeholder*.

679. The matters that may have material influence on the credit rating are specified in Article 310 of COOFIN and include the provision of advice under Article 310(ii) of the COOFIN:

> *"on the structures of financial instruments or the structures of claim pertaining to a monetary loan held against a juridical person, in cases where the object of the Credit Rating is the assessment of such financial instruments or juridical person".*

680. CESR sought further clarifications on the meaning of "financial instrument", based on which CESR understands it is a high level and generic definition for all financial instruments, which include also structured finance products.

681. In addition, Section III-2-2(2) of the Guidelines provides additional details to these prohibitions as discussed in paragraph **668** above.

Box 22

Prohibition to make proposals or recommendations on the design of structured finance products about which the credit rating agency is expected to issue a rating

682. There is an express prohibition for the credit rating agency itself or its officers and employees to provide advice on the structure of financial instruments about which the credit rating agency is expected to issue a rating.

683. CESR understands that structured finance products are covered by the definition of financial instruments and, as such, the scope of the prohibition in Japan is even broader than the scope of the EU prohibition.

684. CESR therefore considers that the objective of this EU prohibition is met.

c) Credit rating analysts are prohibited from being involved in the negotiation of fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.

685. In Japan, Article 306(1)(xi) of the COOFIN require credit rating agencies to implement measures:

> *"so as to prevent the Person in Charge of Ratings from participating in the negotiation process for determining the Rating Fee for the Credit Rating".*

686. The definition of "rating fee" is set out in Article 299(xxxii) of the COOFIN and includes money and any other property which has been or will be paid to the credit rating agency as a consideration for determining a credit rating.

687. The definition of "person in charge of rating" is set out in Article 295(3)(v) of the COOFIN and includes both credit rating analysts and members of the rating committee which make the final decision on the rating.

688. Additionally, Section III-2-1(10) of the Guidelines provides that supervisory departments shall examine how credit rating agencies have developed their operational control systems by taking the following into consideration:

> *"whether the credit rating agency clearly prohibits its person in charge of ratings from participating in negotiations for credit rating fees. Also, whether the credit rating agency has taken appropriate measures, such as separating the division that conducts its credit rating activities from the division that negotiates the credit rating fees."*

689. So both in the EU and in Japan, rating analysts are prohibited from being involved in the negotiation of fees with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.

690. In Japan, the measures adopted to prevent persons in charge from participating in the negotiation process for the determination of the rating entity for the credit rating are to be disclosed to the JFSA as part of the registration process as well as to the public on an annual basis in the explanatory documents to be published on an annual basis[47].

Box 23

Prohibition to be involved in the negotiation of fees or payments

691. Credit rating analysts are prohibited from being involved in the negotiation of fees with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.

692. The prohibition also applies to members of the rating committee responsible for the rating decision and, in this respect, is broader than the EU prohibition.

693. CESR therefore considers that the objective of this EU requirement is met.

47 Article 299(xxxii) and Article 318(1)(iii)(j) of the COOFIN.

Requirements of paragraph 113 above

694. These requirements are that those persons referred to in Annex 1 Section C points 1, 2, 4, 6 of the EU Regulation are prohibited from:

a) engaging in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity;
b) participating in or otherwise influencing the determination of a credit rating if those persons own financial instruments of the rated entity or any entity related to a rated entity or have had a recent employment or other business relationship with the rated entity that may cause a conflict of interest;
c) soliciting or accepting monies, gifts or favours from anyone with whom the credit rating agency does business;
d) from taking key management positions with the rated entity or its related third party within 6 months of the rating.

(a) Engaging in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity

695. This EU requirement is covered by the Japanese rules set out in Article 66-35(i) of the Act (as discussed in paragraphs **602** to **605** above) and Article 306(1)(vii)(a)(1) of the COOFIN which obliges credit rating agencies to take:

"measures to prevent Person in Charge of Rating from conducting any Sales and Purchases or Other Transactions of Securities, etc. which may entail any Conflicts of Interest".

696. Additionally, Section III-2-1(6)(ii)(d) of the Guidelines provides that supervisory departments shall examine how credit rating agencies have developed their operational control systems by taking the following into consideration:

"Whether the credit rating agency has clearly established in advance the criteria for which cases correspond to cases where "a person in charge of rating conducts a sale, purchase or other transaction of securities, etc. with a potential conflict of interest" as prescribed in Article 306(1)(vii)(A)1. of the FIB Cabinet Office Ordinance, and "cases where there is a potential conflict of interest between an officer or employee and a rating stakeholder" as prescribed in clause (A)2. of the same article; and in applicable cases, whether there is a system in place to prevent officers and employees from being involved in processes relating to the determination of the credit rating. Also, whether the credit rating agency examines the validity and effectiveness of the said criteria in a timely and appropriate manner, and makes revisions as necessary".

697. The details of the measures to be implemented in order to prevent credit rating analysts and members of the rating committee responsible for the rating decision from conducting transactions in financial instruments that may entail conflicts of interest have to be provided to the JFSA as part of the registration process[48]. A credit rating agency shall also disclose to the public, in the explanatory documents that have to be prepared on an annual basis, the types of Specified Acts and an outline of the measures for the avoidance of conflicts of interest.[49]

48 Article 299(xxii) of the COOFIN.
49 Article 318(1)(iii)(e) of the COOFIN.

Box 24

Prohibition for persons involved in credit rating activities to be engaged in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity

698. Credit rating agencies are required to implement, as part of their operational control systems, measures to prevent credit rating analysts and members of the rating committee responsible for the determination of the rating from being involved in any transaction that may involve a conflict of interest.

699. The details of the measures that need to be established have to be included as part of the registration process to the JFSA. Credit rating agencies are also required to make public in the explanatory documents that need to be prepared on an annual basis information on the types of Specified Acts and the measures implemented to avoid conflicts of interest.

700. CESR considers that the objectives of this provision are met through detailed and comprehensive requirements which are similar to the EU prohibition.

(b) Participating in or otherwise influencing the determination of a credit rating if those persons own financial instruments of the rated entity or any entity related to a rated entity or have had a recent employment or other business relationship with the rated entity that may cause a conflict of interest

701. This EU requirement is covered by the Japanese rules set out in Article 66-35(i) of the Act (as discussed in paragraphs **602** to **605** above) and Article 306(1)(vii)(a)(1) and (2) of the COOFIN which obliges credit rating agencies to take:

> *"1. measures to prevent Person in Charge of Rating from conducting any Sales and Purchases or Other Transactions of Securities, etc. which may entail any Conflicts of Interest;"[*and]
>
> *"2. the measures to prevent any Officer or employee who has any potential Conflicts of Interest with a Rating Stakeholder, if any, from participating in the process of determining the Credit Rating of any matter in which said Rating Stakeholder has an interest."*

702. As discussed in paragraph **670** above, the definition of *rating stakeholders* does include the concept of "related third party" under the EU Regulation.

703. Additionally, Section III-2-1(6)(ii)(d) of the Guidelines provides additional details on what the supervisory departments need to examine in relation to these measures, as discussed in paragraph **696** above.

704. Details of the measures referred to in paragraph **701** above have to be provided to the JFSA as part of the registration process[50]. A credit rating agency shall also disclose to the public, in the explanatory documents that have to be prepared on an annual basis, the types of Specified Acts and an outline of the measures for the avoidance of conflicts of interest.[51]

50 Article 299(xxii)and(xxiii) and Article 299(xxiii) of the COOFIN.
51 Article 318(1)(iii)(e) of the COOFIN.

Box 25

Prohibition for persons involved in credit rating activities to participate in or otherwise influencing the determination of a credit rating if those persons own financial instruments of the rated entity or related third party or have had a recent employment or other business relationship with the rated entity that may cause a conflict of interest

705. Credit rating agencies are required to implement, as part of their operational control systems, measures to: (i) prevent credit rating analysts and members of the rating committee responsible for the determination of the rating from being involved in any transaction that may involve a conflict of interest; (ii) to prevent any officer or employee who has any potential conflicts of interest with a *rating stakeholder* from participating in the process of determining the relevant credit rating.

706. The details of the measures that need to be established have to be included as part of the registration process to the JFSA. Credit rating agencies are also required to make public in the explanatory documents that need to be prepared on an annual basis information on the types of Specified acts and the measures implemented to avoid conflicts of interest.

707. CESR considers that the objectives of this provision are met through detailed and comprehensive requirements which are similar to the EU prohibition.

(c) Soliciting or accepting monies, gifts or favours from anyone with whom the credit rating agency does business

708. This requirement is met by the provision of Article 66-35(iii) of the Act (as discussed in paragraph **286c)** above) and Article 312(ii) of the COOFIN, which provide that:

> *"A Credit Rating Agency or the Officers or employees thereof shall not conduct:*
>
> *(ii) the act of any Person in Charge of Rating of a Credit Rating Agency, in the process of determining a Credit Rating, of accepting any money or goods delivered by any Rating Stakeholder, to demand the delivery thereof, or to accept an offer for the delivery thereof (excluding the cases where the total value of such money or goods received in the same day is three thousand yen or less, and the cases as may be necessary in the course of trade)".*

709. Credit rating agencies are required to disclose to the JFSA and to make public in the explanatory documents that need to be prepared on annual basis information on the measures implemented to avoid conflicts of interest.

Box 26

Prohibition for persons involved in credit rating activities to solicit or accept monies, gifts or favours from anyone with whom the credit rating agency does business

710. There is an express prohibition for the credit rating agency, its officers and employees to solicit or accept money or goods whose value is greater than a certain threshold.

711. Credit rating agencies are required to disclose to the JFSA and to make public in the explanatory documents that need to be prepared on an annual basis information on the measures implemented to avoid conflicts of interest.

712. CESR considers that the objectives of this provision are met through detailed and comprehensive requirements which are similar to the EU prohibition.

(d) Prohibition from taking key management positions with the rated entity or its related third party within 6 months of the credit rating

713. This EU requirement is covered by the Japanese rules set out in Article 66-35(i) of the Act (as discussed in paragraphs **602** to **605** above) and Article 306(1)(vii)(a)(4) of the COOFIN which obliges credit rating agencies to take:

> *"measures to prevent Person in Charge of Rating from making any approach in an attempt to assume the position of an Officer or any other position equivalent thereto of the Rating Stakeholder".*

714. However, the Japanese rule does not expressly prevent former employees of a credit rating agency from assuming a key management position at a *rating stakeholder* in general, but only from initiating an approach to the *rating stakeholder*.

715. CESR understands that the objective of the EU requirement is to avoid that a credit rating analyst is somehow influenced in the determination of the credit rating for which he/she is responsible by the fact that he/she will join the rated entity or related third party in a six month period.

716. Article 66-35(iii) of the Act and 312(i) of the COOFIN achieve the same objective by prohibiting the credit rating agency and its officers and employees from promising what a credit rating will be before conducting the necessary credit rating analysis to determine it.

717. In addition, Article 306(1)(vii)(a)(2) of the COOFIN imposes the obligation for a credit rating agency to implement measures to prevent any officer or employee who has a potential conflicts of interest with a *rating stakeholder* from participating in the determination of the relevant credit rating.

718. Furthermore, Section III-2-2(1)(ii) of the Guidelines provides that supervisory departments would take into account:

> *"Whether there is a system in place to prevent officers and employees from being involved in processes relating to the determination of a credit rating, not only in cases where the relationship between the credit rating agency and its officers and employees and a rating stakeholder correspond to a "close relationship," but also in cases where "a person in charge of rating conducts a sale, purchase or other transaction of securities, etc. with a potential conflict of interest" as prescribed in Article 306(1)(vii)(A)1. of the FIB Cabinet Office Ordinance, and "cases where there is a potential conflict of interest between an officer or employee and a rating stakeholder" as prescribed in clause (A)2. of the same article."*

719. Details of the measures referred to in paragraph **713** above and of the measures to avoid conflicts of interest have to be provided to the JFSA as part of the registration process[52]. A credit rating agency shall also disclose to the public, in the explanatory documents that have to be prepared on

52 Article 299(xxi) and Article 299(xxv) of the COOFIN.

an annual basis, the types of Specified Acts and an outline of the measures for the avoidance of conflicts of interest.[53]

Box 27

Prohibition for persons involved in credit rating activities to take key management positions with the rated entity or its related third party within 6 months of the credit rating

720. Although there is not an express prohibition for a former employee of a credit rating agency from assuming a key management position at a rated entity or related third party, the objectives of the EU requirement are achieved through a set of provisions.

721. There is an express prohibition for the credit rating analysts and members of the credit rating committee responsible for approving a credit rating to initiate an approach to take a key management position at a rated entity or related third party.

722. The credit rating agency and its officers and employees are prohibited from promising what a credit rating will be before conducting the necessary credit rating analysis to determine it.

723. A credit rating agency needs to implement measures to prevent any officer or employee who has a potential conflict of interest with a rated entity or related third party from participating in the determination of the relevant credit rating.

724. Credit rating agencies are required to disclose to the JFSA and to make public in the explanatory documents that need to be prepared on an annual basis information on the types of Specified Acts and the measures implemented to avoid conflicts of interest.

Box 28

CONFLICTS OF INTEREST MANAGEMENT

725. CESR considers the Japanese requirements in terms of conflicts of interest management overall meet the objectives of the EU requirements for the reasons explained above and set out below for ease of reference.

I. Requirements of paragraph 111 above

726. CESR considers the Japanese framework includes specific and comprehensive requirements through the explicit provisions of the Act, the COOFIN and the Guidelines through which the objectives of the conflicts of interest requirements set out in Paragraph 111 above are met as discussed below.

a) Identify and eliminate or alternatively manage and disclose conflicts of interest; Establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate or manage and disclose any conflicts of interest); Disclose any actual and potential conflicts of interest

53 Article 318(1)(iii)(e) of the COOFIN.

727. **There are specific and detailed requirements obliging a credit rating agency to identify, prevent, manage and disclose any actual or potential conflicts of interest ("Specified Acts"), as well as Guidelines which further explain how these requirements are expected to be met in practice.**

b) Be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities

728. **The requirement that the credit rating agency is organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities is met through the general obligation for a credit rating agency (i) to perform business fairly and independently, and (ii) to implement measures in order to identify, prevent, manage and disclose conflicts of interest.**

c) Identify, eliminate or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgment of its ratings analysts, employees and other natural persons whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuance of credit ratings and persons approving credit ratings

729. **The Japanese framework contains specific requirements obliging a credit rating agency to ensure that conflicts of interest that may influence the judgements of individuals involved in the credit rating activities are identified, prevented, managed and disclosed.**

d) ***Publicly disclose the names of the rated entities or related third parties from which it receives more than 5% of its annual revenue***

730. **A credit rating agency needs to publicly disclose the names of the rated entities from which it receives more than 10% of its annual revenue.**

731. **CESR concludes that, although the Japanese rules set a different threshold for the disclosure (10% instead of 5% in the EU Regulation), the overall objective of this requirement is met.**

e) Not issue a credit rating or in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex 1 section B paragraph 3 of the EU Regulation

732. **The overall objective of the requirement that the credit rating agency does not issue or rating, or in the case of an existing rating immediately discloses that the rating is potentially affected in the circumstances set out in Annex 1 Section B paragraph 3 of the EU Regulation, is met through the interaction of the provisions that: (i) set out the prohibition on a credit rating agency or its officers and employees to provide a credit rating in relation to a rated entity where there is some form of "close relationship" between them; (ii) specify the nature of the "close relationships" that are prohibited, (iii) set out the nature of the interests by the rated entity in the credit rating; (iv) impose an obligation to implement measures to identify, prevent, manage and disclose potential or actual conflicts of interest.**

f) Ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party

733. There are extensive and detailed provisions aimed at avoiding conflicts of interest between the performance of ancillary services and credit rating activities, accompanied by disclosure obligations concerning the type and status of ancillary services.

734. Unlike in the EU, in Japan there is no requirement for credit rating agencies to disclose in rating reports ancillary services provided for the rated entity or any other related third party. However, there is a disclosure, during the registration phase as well as an on-going basis (in the business report to the JFSA and the explanatory documents made available to the public).

g) Design its reporting and communication channels so as to ensure independence of related persons from the other activities of the credit rating agency carried out on a commercial basis

735. A credit rating agency is required to implement operational control systems in order to ensure that credit rating activities are carried out fairly and objectively, that no conflicts of interest arise between these activities and the ancillary services it carries out, and that persons in charge for ratings are prevented from participating in the negotiations of the relevant fees.

736. CESR understands that these operational control systems require the establishment of appropriate reporting and communication channels to ensure independence of persons involved in the determination of the credit rating business.

h) Ensure that compensation and performance evaluation of the rating analysts and persons approving the credit ratings are not linked to the amount of revenue they generate

737. A credit rating agency needs, as part of its operational control systems, to implement measures ensuring that the remuneration of rating analysts and members of rating committee is not affected by the amount of the consideration received for determining the credit rating.

i) Reporting illegal conduct to the compliance officer without negative consequences

738. There is a specific requirement for a credit rating agency to implement measures to ensure that illegal conducts may be reported without negative consequences.

j) Require that when a rating analyst terminates his or her employment and joins a rated entity there is a review of the relevant work of that analyst

739. There is an explicit requirement for a credit rating agency to verify ratings after a former rating analyst has assumed an employment with a rated entity or a financial firm with which he or she has had dealings as part of his or her duties at the credit rating agency. In addition, there are disclosure requirements to both the JFSA and the public regarding this matter.

k) Establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings

740. The Japanese framework does include a specific requirement to implement a rotation mechanism, allowing credit rating agencies to decide between two possible way of implementing the provision, which goes in line with the Japanese pragmatic approach to the need to tailor the requirements to the specific size and complexity of the credit rating agency.

741. **Although option 1 of the Japanese rotation regime applies only to lead analysts, but not to all other rating analysts or persons approving credit ratings, CESR is satisfied that this rule does meet the objectives of the EU Regulation. The same applies to option 2 of the Japanese rotation regime which, on the one side, only provides for the rotation of a third of the members of a rating council and which, to this end, is less strict than the rotation of 100% of the persons involved, but which, on the other hand, needs to be effected already after one participation in a rating council decision only if the same *rating stakeholder* has an interest, instead of every five years as provided in the EU Regulation for lead analysts.**

742. **Irrespective of the fact that an exemption in relation to the rotation requirement can be granted in very limited circumstances, CESR is satisfied that the objectives of this requirement are met.**

II. Requirements of paragraph 112 above

743. **CESR considers the Japanese framework includes specific and comprehensive requirements through the explicit provisions of the Act, the COOFIN and the Guidelines through which the objectives of the conflicts of interest requirements set out in paragraph 112 above are met as discussed below.**

a) Prohibition to provide consultancy or advisory services

744. **Credit rating agencies are expressly prohibited from providing consultancy services to the rated entity and also in CESR's understanding to related third parties regarding their organisation or assets and liabilities.**

b) Prohibition to make proposals or recommendations on the design of structured finance products about which the credit rating agency is expected to issue a rating

745. **There is an express prohibition for the credit rating agency itself or its officers and employees to provide advice on the structure of financial instruments about which the credit rating agency is expected to issue a rating.**

746. **CESR understands that structured finance products are covered by the definition of financial instruments and, as such, the scope of the prohibition in Japan is even broader than the scope of the EU prohibition.**

c) Prohibition to be involved in the negotiation of fees or payments

747. **Credit rating analysts are prohibited from being involved in the negotiation of fees with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.**

748. **The prohibition also applies to members of the rating committee responsible for the rating decision and, in this respect, is broader than the EU prohibition.**

III. Requirements of paragraph 113 above

749. **CESR considers the Japanese framework includes specific and comprehensive requirements through the explicit provisions of the Act, the COOFIN and the Guidelines**

through which the objectives of the conflicts of interest requirements set out in paragraph 113 above are met as discussed below.

a) Prohibition for persons involved in credit rating activities to be engaged in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity

750. Credit rating agencies are required to implement, as part of their operational control systems, measures to prevent credit rating analysts and members of the rating committee responsible for the determination of the rating from being involved in any transaction that may involve a conflict of interest.

751. The details of the measures that need to be established have to be included as part of the registration process to the JFSA. Credit rating agencies are also required to make public in the explanatory documents that need to be prepared on an annual basis information on the measures implemented to avoid conflicts of interest.

b) Prohibition for persons involved in credit rating activities to participate in or otherwise influencing the determination of a credit rating if those persons own financial instruments of the rated entity or related third party or have had a recent employment or other business relationship with the rated entity that may cause a conflict of interest

752. Credit rating agencies are required to implement, as part of their operational control systems, measures to: (i) prevent credit rating analysts and members of the rating committee responsible for the determination of the rating from being involved in any transaction that may involve a conflict of interest; (ii) to prevent any officer or employee who has any potential conflicts of interest with a *rating stakeholder* from participating in the process of determining the relevant credit rating.

753. The details of the measures that need to be established have to be included as part of the registration process to the JFSA. Credit rating agencies are also required to make public in the explanatory documents that need to be prepared on an annual basis information on the measures implemented to avoid conflicts of interest.

c) Prohibition for persons involved in credit rating activities to solicit or accept monies, gifts or favours from anyone with whom the credit rating agency does business

754. There is an express prohibition for the credit rating agency, its officers and employees to solicit or accept money or goods whose value is greater than a certain threshold.

755. Credit rating agencies are required to disclose to the JFSA and to make public in the explanatory documents that need to be prepared on an annual basis information on the types of Specified Acts and the measures implemented to avoid conflicts of interest.

d) Prohibition for persons involved in credit rating activities to take key management positions with the rated entity or its related third party within 6 months of the credit rating

756. Although there is not an express prohibition for a former employee of a credit rating agency from assuming a key management position at a rated entity or related third party, the objectives of this EU requirement is achieved through a set of provisions.

757. There is an express prohibition for the credit rating analysts and members of the credit rating committee responsible for approving a credit rating to initiate an approach to take a key management position at a rated entity or related third party.

758. The credit rating agency and its officers and employees are prohibited from promising what a credit rating will be before conducting the necessary credit rating analysis to determine it.

759. A credit rating agency needs to implement measures to prevent any officer or employee who has a potential conflict of interest with a rated entity or related third party from participating in the determination of the relevant credit rating.

760. **Credit rating agencies are required to disclose to the JFSA and to make public in the explanatory documents that need to be prepared on an annual basis information on the types of specified Acts and the measures implemented to avoid conflicts of interest.**

D. Organisational requirements

761. The EU mandate required CESR to check at least the following issues in this Section:

Extract from the mandate

- A CRA keeps records and audit trails of all its activities;
- A CRA has a compliance function, which operates independently

762. In addition to the above, CESR's approach to assessing the equivalence of the EU Regulation's organisational requirements, as set out in paragraphs **125** to **146** above makes it clear that this is an area where CESR anticipates there may be differences and as such is not expecting all of the EU Regulation's requirements to be in place in a third country.

763. The organisational requirements set out in the EU Regulation can be divided into the following four areas:

- General organisational requirements
- Outsourcing
- Confidentiality
- Record keeping

764. The overall objective of the organisational requirements is that they contribute to ensuring the objectivity, independence, integrity and quality of the credit rating activities.

GENERAL ORGANISATIONAL REQUIREMENTS

765. As described in paragraph **128** above, for the purposes of assessing equivalence, CESR expects that the requirements in place in the third country, as a package, ensure that the objectives of the six requirements listed below are met. Credit rating agencies should be required to:

a) establish adequate policies and procedures that ensure compliance of the credit rating agency's obligations under the relevant regulation;
b) have sound administrative and accounting procedures, internal control mechanisms designed to secure compliance with decisions and procedures at all levels, effective procedures for risk assessment, effective control and safeguard arrangements for information processing systems;
c) implement and maintain decision making procedures and organisational structures that clearly and in a documented manner specify reporting lines and allocates functions and responsibilities;
d) establish and maintain a permanent and effective compliance function which operates independently;
e) employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of the credit rating agency's credit rating activities;
f) monitor and evaluate the adequacy and effectiveness of the credit rating agency's systems, internal control mechanisms and arrangements established in accordance with the authorities' requirements and take appropriate measures to address any deficiencies.

How the Japanese legal and regulatory requirements meet the EU requirements

766. Before going into the specifics of the Japanese requirements, CESR points out that Article 66-33 of the Act requires a credit rating agency to establish operational control systems, the organisational requirements of which in the Japanese regulatory framework are one of the four pillars of the framework as discussed in paragraphs **279** to **285** above. Moreover, the framework contains a number of other requirements as discussed in the following section.

767. As described in paragraph **282** above, Article 306(1)(i to xvii) of the COOFIN describes in detail the operational control systems required to be established by a credit rating agency pursuant to Article 66-33 of the Act, and the Guidelines set out additional details, the relevant provisions of which are set out below.

a) Establish adequate policies and procedures that ensure compliance of the credit rating agency's obligations under the relevant regulation

768. The Japanese equivalent of this EU requirement as set out in paragraph **502** above, Article 306 (1)(v)(a)-(c) of the COOFIN which requires that credit rating agencies that wish to operate in Japan have to establish and implement measures to secure compliance with laws and regulations.

769. This includes:

- the formulation of policies and procedures for compliance with laws and regulations;
- policies to clearly define responsibilities with laws and regulations, such as the appointment of a chief compliance officer;
- measures for handling cases where employees have violated laws and regulations.

770. Article 66-38 of the Act requires that as part of the application process, certain information needs to be provided, the details of which are in respect of compliance with laws and regulations set out in Article 299 of the COOFIN.

771. More specifically, Article 299 (viii) and (ix) of the COOFIN requires the credit rating agency to set out the following in a document attached to its written application for registration:

"(viii) the policies and procedures for Compliance with Laws and Regulations, etc.;
(ix) policies which clearly define the roles and responsibilities for Compliance with Laws and Regulations, etc. such as the appointment of a Chief Compliance Officer;"

772. According to Article 318(1)(iii)(c) of the COOFIN, a credit rating agency needs also to disclose information on the measures for securing compliance with laws and regulations to the public, as part of the explanatory documents to be prepared and published on an annual basis.

773. In addition, Section III-2-1(4)(i) of the Guidelines provides the following instructions to supervisory departments regarding which measures for ensuring legal compliance need to be in place when examining how credit rating agencies have developed their operational control systems as follows:

"(i) Notes regarding the policy and procedures pertaining to legal compliance
(a) Whether the credit rating agency regards legal compliance as one of the most important issues for management, and whether it has formulated a basic policy concerning the implementation of compliance, as well as a detailed implementation plan (compliance program) and a code of conduct (ethics code, compliance manual, etc.)

(b) Whether the credit rating agency has clearly established the authority and responsibility of the chief compliance officer, and whether there is a system in place for his/her function to be fully exercised.
(c) Whether the credit rating agency has established a system for communicating and reporting compliance-related information appropriately among the management team, the divisions in charge of the credit rating activities,, and the legal compliance division, chief compliance officer or other person in charge.
(d) Whether the credit rating agency has established and enhanced systems for training and education on legal compliance, and whether it strives to foster and raise awareness of legal compliance among officers and employees. Also, whether it strives to ensure the effectiveness of training by, for example, conducting evaluation and follow-up in a timely manner and by reviewing and revising the contents thereof.
(Note) In addition, supervisory departments shall also take III-2-2 into consideration regarding legal compliance pertaining to the prohibited acts of credit rating agencies and of their officers and employees."

b) Have sound administrative and accounting procedures, internal control mechanisms designed to secure compliance with decisions and procedures at all levels, effective procedures for risk assessment, effective control and safeguard arrangements for information processing systems

774. In light of the number of requirements that the Japanese legal and regulatory framework has in respect of this set of EU requirements, the discussion below will be further divided into each requirement as follows:

- sound administrative and accounting procedures;
- internal control mechanism designed to secure compliance with decisions and procedures at all levels;
- effective procedures for risk assessment; and
- effective control and safeguard arrangements for information processing systems.

b(i) Have sound administrative and accounting procedures

775. The Japanese equivalent of this EU-requirement is Article 306 (1)(iv) of the COOFIN which requires credit rating agencies to have measures (policies and procedures) for establishing systems for securing the proper business operation of a credit rating agency..

776. This article requires the credit rating agency to implement*:*

"a) A system to ensure that the Officers will execute their respective duties efficiently;
b) A system for the preservation and management of information on the execution of duties by officers; and
c) *Regulations and any other system for management of risk of loss."*

777. In addition, a credit rating agency is subject to extensive record keeping requirements, that are set out in Article 315 of the COOFIN (as discussed in paragraphs **845** to **853** below), and needs to have procedures in place for securing compliance with laws and regulations, including these record-keeping requirements.

778. According to Section III-3-4 of the Guidelines, a credit rating agency is expected to have established specific methods for preparing and storing the books and documents required under the Japanese credit rating agency legislation.

779. CESR notes that the Japanese regulatory framework has no explicit requirement setting out the nature of these policies and procedures in terms of having "sound" administrative and accounting procedures in place, but CESR is satisfied that the requirements in place meet the objectives of the EU requirement.

b (ii) Have internal control mechanisms designed to secure compliance with decisions and procedures at all levels

780. In relation to this EU requirement, as described in paragraph **775** above, Article 306 (1)(iv) of the COOFIN sets out the requirement on the credit rating agency as part of its operational system requirement to have "*systems for securing the proper operation of the credit rating agency"* which CESR understands from discussions with the JFSA's staff is an internal control mechanism.

781. In addition, Article 299(vii) of the COOFIN specifies that the details of the measures to be implemented for establishing systems to secure the adequacy of the operation of the credit rating agency have to be included as part of the application process.

782. Information on these measures needs to be made available to the public in the explanatory documents to be prepared and published on an annual basis, according to Article 318(1)(iii)(b) of the COOFIN.

783. Section III-2-1(3) of the Guidelines adds further details to this requirement in terms of the obligations imposed on the senior management of the credit rating agency in relation to this requirement, as well the need for the credit rating agency to periodically review the internal control system as follows:

"(3) Measures for ensuring the appropriateness of the business of a credit rating agency (internal control system)
(i) Whether the board of directors, etc. recognizes the importance of developing internal control systems for the purpose of ensuring the appropriateness of the company business activities, and whether it has built an adequate system suited to the characteristics, size, complexity and other attributes of its own business.
(ii) Whether the credit rating agency periodically examines the validity and effectiveness of the internal control system it has built, and makes revisions as necessary."

784. In addition to the above, Section III-2-1(4)(i)(c) of the Guidelines sets out that the credit rating agency is expected to have a system for : *'communicating and reporting compliance related information appropriately among the management team, the divisions in charge of the credit rating activities and the legal compliance division, chief compliance officer or other person in charge*' – which CESR understands to mean that there needs to be a system to secure compliance with decisions and procedures at all levels.

b (iii) Have effective procedures for risk assessment

785. When assessing effective procedures for risk assessment, the Japanese regulatory framework contains a requirement to implement *"regulations and any other system for management of risk of loss."* This requirement is set in Article 306 (1)(iv)(c) of the COOFIN as can be seen in paragraph **774** above.

786. CESR understands that establishing measures to develop systems so as to ensure the fairness of operations that relate to the management of a risk of loss according to Article 306(1)(iv)(c) of the COOFIN can be identified as establishing a risk assessment system.

787. In addition, CESR understands following further clarification from the JFSA's staff that "operational risk" is covered by this article mentioned above, as the risk assessment is expected to cover all risks.

788. Article 299(vii) of the COOFIN requires the credit rating agency to provide information about how it will meet this requirement as part of the application process.

789. Information on the internal control systems, including procedures for risk assessment, needs to be provided in the explanatory documents on an annual basis, according to Article 318(1)(iii)(b) of the COOFIN.

b (iv) Have effective control and safeguard arrangements for information processing systems

790. The Japanese legislation does not explicitly contain a requirement to have effective control and safeguard arrangements for information processing systems, however credit rating agencies are required to implement *"systems for the preservation and management of information.*[54]*"*

791. Credit rating agencies also need to implement measures to properly manage confidential information under Article 306(1)(xii) of the COOFIN, as well as to establish measures to manage risks, including operational risks pertaining to the information processing system[55].

792. CESR understands that all information relating to the business of the credit rating agency is kept and managed. The objective is to record relevant information and ensure that the decision making is well documented.

c) Implement and maintain decision making procedures and organisational structures that clearly and in a documented manner specify reporting lines and allocate functions and responsibilities

793. Article 306 of the COOFIN sets out the measures related to the establishment and implementation of operational control systems, including policies for quality control of processes in the determination of credit ratings.

794. CESR understands that the development of operational control systems includes the establishment of decision making procedures, an organisational structure, and reporting lines within a credit rating agency.

795. According to Article 66-28(2)(ii) of the Act (see paragraph **349** above) and Article 299 of the COOFIN, a credit rating agency needs to attach documents to the application form containing, among other things, information on (i) the method of allocation of the business[56], (ii) policies that clearly define the roles and responsibilities for compliance with laws and regulations[57], (iii) the composition, method of appointment and functioning of the rating committee[58]; (iv) the method of

54 Article 306(1)(iv)(b) of the COOFIN.
55 Article 306(1)(iv)(c) of the COOFIN.
56 Article 299(iii) of the COOFIN.
57 Article 299(ix) of the COOFIN.
58 Article 299(xiii) of the COOFIN

appointment of a person responsible for supervising credit rating analysts[59]; (v) assignment of duties between rating analysts[60]; (vi) the operational policies of the Supervisory Committee[61].

796. According to Article 300(i) of the COOFIN, as part of the registration process, a credit rating agency needs also to provide information to the JFSA on:

"(i) the documents describing the business execution system, such as its personnel structures and operational control systems pertaining to the business."

797. In addition, in the explanatory documents to be prepared on an annual basis under Article 318(i)(c),(iii)(m),(iv) of the COOFIN, a credit rating agency needs to publicly disclose certain information concerning its decision making procedures and organisational structures, including, among other things, information on the organisational structure, the operational policies of the Supervisory Committee, as well as information on the group to which the credit rating agency belongs.

798. The explanatory documents will be published and have to be updated annually.

799. According to the Guidelines (Section III-1 Governance), the supervisory departments are expected to examine the governance of the credit rating agency and consider, in particular, whether the management team discharges its responsibilities in an effective and appropriate way, also taking into account the characteristics, size and complexity of the credit rating agency.

800. In addition, as extensively discussed throughout this section of the advice, the Guidelines contain details on how the supervisory departments intend to evaluate the various credit rating agencies' administrative procedures.

d) Establish and maintain a permanent and effective compliance function which operates independently

801. Article 306(1)(v)(b) of the COOFIN imposes the obligation on the credit rating agency to define policies to clearly define responsibilities with regard to compliance with laws and regulations, such as the appointment of a "Chief Compliance Officer".

802. CESR points out and notes that the requirement makes use of the words "such as", suggesting that the appointment of such an individual is optional. However, based on further clarification from the staff of the JFSA CESR understands that, irrespective of the use of the above terms, the appointment of the chief compliance officer is not optional. This is reinforced by the number of provisions relating to disclosure of information regarding procedures for the appointment and remuneration of such an individual.

803. The role of the compliance officer is defined in Article 295(3)(vii) of the COOFIN as *"a person in charge of implementing measures so as to ensure Compliance with Laws and Regulations"*.

804. As discussed in paragraphs **535** to **545** above, there is no specific requirement that the Chief Compliance Officer has per se to be "independent", but CESR is conformable that the Japanese requirements that are in place should in practice ensure the independence of this individual.

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59 Article 299(xiv) of the COOFIN.

60 Article 299(xii) of the COOFIN.

61 Article 299(xxxv) of the COOFIN.

805. Independence in the context of the EU regulation means:

"(c) the managers, rating analysts, employees and any other natural person whose services are placed at the disposal or under the control of the credit rating agency or any person directly or indirectly linked to it by control who is involved in the compliance function is not involved in the performance of credit rating activities they monitor;
(d) the compensation of the compliance officer is not linked to the business performance of the credit rating agency and is arranged so as to ensure the independence of his or her judgement."

806. In the Japanese regulatory framework, a compliance officer is not prohibited per se from being involved in credit rating activities, but according to Article 306 (1)(x)(a) of the COOFIN the credit rating agency has to have processes in place to ensure that the compensation of the compliance officer is not affected by the performance of the credit rating agency's business.

807. The remuneration policy of officers and employees is required under the provision of Article 299(xxx) of the COOFIN to be disclosed to the JFSA as part of the application process, as well as needing to be made available to the public in the explanatory documents that are required to be prepared and published for each business year[62].

808. CESR understands following additional clarification on this point from the staff of the JFSA, that in order to comply with Articles 66-32 and 66-33 of the Act, a credit rating agency in Japan is required to have an independent mechanism in place to select a compliance officer which then can act on an independent basis.

809. Further, CESR notes that the Supervisory Committee is in charge of monitoring the compliance with internal policies and procedures and the work of the compliance officer.

810. In addition, Section III-2-1(9) of the Guidelines sets out that, in assessing if a credit rating agency implements measures pertaining to the policy for determining the remuneration of officers and employees, the supervisory departments would take into account:

"Whether the credit rating agency has properly established a policy for determining the remuneration, etc. of officers and employees, and whether it is applying the policy appropriately. Also, whether the credit rating agency examines, in a timely and appropriate manner, whether the content of the said policy is undermining the fair and appropriate execution of its credit rating business, and whether it makes revisions as necessary."

e) Employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities

811. The Japanese regulatory framework covers this EU requirement by Article 306(1)(vi)(a) of the COOFIN which requires the credit rating agency to have:

"(a) the measures to retain sufficient staffs with the expert knowledge and skills which enable them to implement appropriately and smoothly the operation of the Credit Rating Business (in cases where its final decision as a Credit Rating Agency in determining a Credit Rating is to be made by a resolution of the council, the method of the appointment of the council members, the decision-making process of such council, and any other measures so as to ensure that employees can exercise their expert knowledge and skills in an appropriate manner shall also be included)."

62 Article 318(1)(iii)(i) of the COOFIN.

812. In addition, Article 306 (1)(xiv) of the COOFIN requires to have operational control systems ensuring:

"(xiv) that the measures for the performance of the Credit Rating Business in accordance with the Rating Policy, etc. (including measures pertaining to training of Rating Analysts) have been implemented."

813. The articles mentioned in the paragraphs above include measures for securing sufficient personnel who have the expertise and skills necessary for the proper and smooth conduct of credit rating business as set out in paragraphs **279** and **290** above.

814. CESR understands that human resources are the key factor to meet this requirement.

815. In addition, Article 306(1)(iv) of the COOFIN provides for the need to implement systems for securing the proper business operation of the credit rating agency.

816. Although there is no specific requirement to ensure continuity and regularity in the performance of rating activities, Article 306(1)(vi)(a) of the COOFIN set out in paragraph **811** above makes reference to appropriate and smooth operation of the business. CESR understands that this means basically the same as continuity and regularity in the performance of rating activities.

817. Credit rating agencies are also required to comply with requirements relating to rating policies according to Article 66-36 of the Act. This means that a credit rating agency has to establish relevant policies and procedures to determine and disclose its credit ratings and have to comply with them. More details are set out in paragraph 301 above.

818. In addition, Article 299 of the COOFIN sets out further requirements in relation to the information to be provided to the JFSA as part of the application form in relation to the credit rating agency's administrative policies, including on the following:

- *"the policies for the recruitment of employees (excluding Rating Analysts);*
- *"the policies on the recruitment and training of Rating Analysts"*[63].

819. In addition Section 111-2-1 (2) of the Guidelines provides additional detail regarding the nature of the knowledge and experience that officers and employees need to have.

f) *Monitor and evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with the authorities' requirements and take appropriate measures to address any deficiencies*

820. In the Japanese regulatory framework this aspect is covered by the Supervisory Committee described in the corporate governance section above (see paragraphs **491** to **553** above).

63 Article 299(vi) and (xi) of the COOFIN.

Box 29

GENERAL ORGANISATIONAL REQUIREMENTS

821. CESR concludes that, overall, the objectives of the general organisational requirements set out in paragraph **765a)** to **f)** above of the EU Regulation are met through extensive operational controls systems requirements, record-keeping and disclosure requirements set out in the Act, the COOFIN and the Guidelines.

822. More specifically, there are provisions obliging a credit rating agency to:

a) establish adequate policies and procedures that ensure compliance with the credit rating agencies' legal and regulatory obligations;

b) have sound administrative and accounting procedures, internal control mechanisms designed to secure compliance with procedures and decisions at all levels, effective procedures for risk assessment and effective control and safeguard arrangements for information processing systems;

c) implement and maintain decision making procedures and organisational structures that clearly and in a documented manner specify reporting lines and allocate functions and responsibilities;

d) establish and maintain a permanent and effective compliance function that operates independently.

823. CESR points out that there are a number of two very minor differences, as follows.

824. The first minor difference is that there is no explicit requirement obliging the credit rating agencies to ensure continuity and regularity in the performance of credit rating activities. However, the relevant Japanese requirements make reference to appropriateness and smooth operation of the business, which CESR takes to have the same meaning. In addition, CESR considers that the continuity requirement is met also through making sure that sufficient personnel is allocated to the performance of credit rating activities.

825. The second minor difference is that there is no explicit requirement to prohibit the compliance officer per se from being involved in credit rating activities, but according to the relevant Japanese provisions the credit rating agencies do have to have processes in place to ensure that the compensation of the compliance officer is not affected by the performance of the credit rating business. In addition, the Supervisory Committee is in charge of monitoring the overall compliance of the credit rating agency with its internal policies and procedures and the work and responsibilities of the compliance officer.

OUTSOURCING

826. The EU requirements with regard to the outsourcing section are set out in paragraphs **135** to **137** above.

827. The Japanese regulatory regime generally prohibits outsourcing of important operational functions except for certain requirements that, under certain conditions, may be met jointly by credit rating agencies that each register with the JFSA and perform credit rating business as a group.

828. The requirements that may be complied with jointly by credit rating agencies that perform business as a group are related to (a) operational control systems, (b) preparation and announcement of the rating policy, (c) record-keeping and (d) preparation and disclosure of explanatory documents.

829. The conditions under which the said requirements may be complied with jointly by credit rating agencies performing business as a group have been discussed in detail in paragraphs **443** to **455** above.

830. In particular, CESR notes that Section III-2-1 of the Guidelines makes it clear that no part of the operational control systems may be assigned to an unregistered business operator, even if it is a credit rating agency within the group. In addition, there is a need to ensure that there is appropriate cooperation between the board of directors of each credit rating agency and that the systems developed at a level of a group is appropriate in view of the characteristics, size and complexity and other specificities of each credit rating agency.

831. Members of the same group are listed in the application form as discussed in paragraphs **421** to **462** above. CESR understands that a credit rating agency has to list in the registration form all names of legal entities that work together with the applicant in determining credit ratings.

832. Upon further clarification, CESR notes that once this information is disclosed, on-site inspections may be conducted over outsourced entities, which will effectively prevent deviation from the credit rating agencies' legal obligations through outsourcing.

833. Furthermore, credit rating agencies have to supply a list of outsourced functions to the JFSA when applying for registration.

834. Therefore, CESR understands that, excepting the cases mentioned above, a credit rating agency will not be deemed as meeting the operational control system requirements if it outsources material operations and as such is not able to complete the rating process by itself.

835. A registered credit rating agency is prohibited to allow another person to engage in credit rating business under its name according to Article 66-34 of the Act. Section III-2-2(3) of the Guidelines sets out further details in relation to this prohibition.

Box 30

OUTSOURCING

836. CESR concludes that outsourcing of important operational functions is not permitted by the Japanese regulatory framework, except for the possibility for credit rating agencies that each register with the JFSA and perform business as a group, subject to certain conditions, to meet jointly the requirements concerning (a) operational control systems, (b) preparation and announcement of the rating policy, (c) record-keeping and (d) preparation and disclosure of explanatory documents.

837. No part of the operational control systems can be outsourced to an entity that is not registered with the JFSA who maintains the power to supervise and enforce compliance with the relevant requirements. The same applies to outsourcing of the requirements in relation to record keeping, explanatory documents, and rating policy. There is also a need to ensure that the system developed is appropriate for each single credit rating agency. A credit rating agency has to ensure that it meets all requirements of establishing an operational control system and thus is ultimately responsible for tasks outsourced to other units within the same group of credit rating agencies. Hence, CESR has no concern about this.

CONFIDENTIALITY

838. Paragraph **140** above sets out the EU requirements relating to confidentiality. They are important because of the nature of the information that the credit agency and its employees have access to. There is a need to ensure that confidential information is only used for purposes related to credit rating activities and is protected from fraud, theft or misuse.

839. According to Article 306 (1)(xii) of the COOFIN (see paragraph **282** above), credit rating agencies are required to establish methods for managing secret information and for preventing the leakage of secrets obtained while performing credit rating activities.

" (xii) that the following measures have been implemented, so as to properly manage information which may come to the attention in the course of the performance of the Credit Rating Business, as well as to properly maintain the confidentiality thereof;
(a) the measures to ensure that any information or secrecy which may come to the attention in the course of performance of the Credit Rating Business would not be used for any other purpose than the purpose deemed necessary for implementing the Credit Rating Business in a fair and adequate manner;
(b) the measures to prevent the leakage of secrecy, by means of identifying the scope of such secret and the scope of persons who may obtain such secrecy in the course of their business, and specifying the method of the management of such secrecy;"

840. CESR understands that this management of confidential information is reasonable to consider the same objective and concept is shared as within the EU Regulation.

841. Upon further clarification, CESR notes that the relevant requirement does not have any restriction in terms of the scope of its application. This very broad requirement includes those who can mismanage the information which then have to comply with the measures.

842. In addition Section III-2-1(11) of the Guidelines states, that in examining the measures established by the credit rating agency for the appropriate conduct of information management and confidentiality, the supervisory departments would take into account:

"(i) whether the credit rating agency has established specific criteria for the treatment of information and secrets acquired during the course of its credit rating business, and whether it has fully communicated these criteria to all officers and employees. In particular, whether the credit rating agency ahs, as part of these criteria, clearly prohibited the information and secrets from being used for purposes other than those purposes deemed necessary to conduct the credit rating business fairly and appropriately.
(ii) In addition to identifying the scope of confidentiality and those persons who acquire confidential information in the course of their duties, whether the credit rating agency has, for the purpose of managing confidentiality, put systems in place designed to pre vent the leaking of confidential information- for example, by managing access to confidential information, by formulating measures to prevent the removal of confidential information by insiders, and by making the information management system more robust so as to prevent unauthorised access from the outside. Also, whether there is a system in place whereby the credit rating agency can examine, in a timely and appropriate manner, how the said information and secrets are being managed,"

843. Information on the measures relating to the management of confidential information needs to be provided to the JFSA as part of the registration process, and made available to the public in the explanatory documents to be prepared on an annual basis.[64]

Box 31

CONFIDENTIALITY

844. CESR considers this area is covered in the Japanese regulatory regime, and although the requirements are less detailed, the objectives of the EU confidentiality requirements for the purposes of assessing equivalence are met.

RECORD KEEPING

845. Paragraphs **143** and **144** above set out the EU requirements for effective record keeping which enables a credit rating agency to document the manner in which it meets its legal obligations, as well as allowing its regulator to supervise that this is being done.

846. The Japanese regulatory framework contains extensive record keeping requirements, which form part of the disclosure requirements which form the fourth pillar of the Japanese legal and supervisory framework for credit rating agencies.

847. According to Article 66-37 of the Act, a credit rating agency is required *"pursuant to the provisions of Cabinet Office Ordinance to prepare and preserve the books and documents related to its Credit Rating Business."*

848. Article 315 of COOFIN specifies the record keeping requirements that Article 66-37 of the Act is referring to.

849. There are 10 main types of records as set out below that must be retained, and the Article sets out additional details in relation to some of them:

- ♦ records pertaining to a number of matters related to the determination of credit ratings;
- ♦ records pertaining to a number of matters related to rating stakeholders who have made payments to the credit rating agency in exchange for its credit rating service;
- ♦ outline of the services or products provided by the credit rating agency ;
- ♦ documents related to credit assessments prepared by rating analysts (including unpublished documents);
- ♦ documents describing results of investigation into compliance status with laws and regulations etc.;
- ♦ documents related to specified acts and measures to prevent conflicts of interest;
- ♦ minutes of the Supervisory Committee;
- ♦ records on the course of material negotiations between executives or employees of the credit rating agency and rating stakeholders;
- ♦ documents or electromagnetic records received from investors and other users of credit ratings; and
- ♦ a general ledger.

64 Article 299(xxxiii) and Article 318(1)(iii)(k) of the COOFIN.

850. In addition, there are other requirements relating to the nature of "business reports" that have to be produced by a credit rating agency that are discussed in detail in paragraphs **1311** and **1312** below.

851. Credit rating agencies are required to keep books and documents for a period of 5 years from the date of their preparation according to Article 315 (2) of the COOFIN.

852. Section III-3-4 of the Guidelines set out additional details on how the supervisory departments intend to examine whether credit rating agencies comply with the record-keeping requirements discussed above.

Box 32

RECORD KEEPING

853. Overall, CESR considers the Japanese record keeping requirements are comprehensive and achieve the objective set out in paragraph **144** above.

Box 33

ORGANISATIONAL REQUIREMENTS

854. Overall, CESR considers the Japanese framework meets the objectives of the EU requirements in respect of organisational processes and procedures that a credit rating agency needs to have in place for the reasons explained above and set out below for ease of reference.

I - General Organisational requirements

855. CESR concludes that, overall, the objectives of the general organisational requirements set out in paragraph 765a) to f) above of the EU Regulation are met through extensive operational controls systems requirements, record-keeping and disclosure requirements set out in the Act, the COOFIN and the Guidelines.

856. More specifically, there are provisions obliging a credit rating agency to:

a) establish adequate policies and procedures that ensure compliance with the credit rating agencies' legal and regulatory obligations;

b) have sound administrative and accounting procedures, internal control mechanisms designed to secure compliance with procedures and decisions at all levels, effective procedures for risk assessment and effective control and safeguard arrangements for information processing systems;

c) implement and maintain decision making procedures and organisational structures that clearly and in a documented manner specify reporting lines and allocate functions and responsibilities;

d) establish and maintain a permanent and effective compliance function that operates independently.

857. CESR points out that there are two very minor differences, as follows.

858. The first minor difference is that there is no explicit requirement obliging the credit rating agencies to ensure continuity and regularity in the performance of credit rating activities. However, the relevant Japanese requirements make reference to appropriateness and smooth operation of the business, which CESR takes to have the same meaning. In addition, CESR considers that the continuity requirement is met also through making sure that sufficient personnel is allocated to the performance to credit rating activities.

859. The second minor difference is that there is no explicit requirement to prohibit the compliance officer per se from being involved in credit rating activities, but according to the relevant Japanese provisions the credit rating agencies do have to have processes in place to ensure that the compensation of the compliance officer is not affected by the performance of the credit rating business. In addition, the Supervisory Committee is in charge of monitoring the overall compliance of the credit rating agency with its internal policies and procedures and the work and responsibilities of the compliance officer.

II – Outsourcing

860. CESR concludes that outsourcing of important operational functions is not permitted by the Japanese regulatory framework, except for the possibility for credit rating agencies performing business as a group, subject to certain conditions, to meet jointly the requirements concerning (a) operational control systems, (b) preparation and announcement of the rating policy, (c) record-keeping and (d) preparation and disclosure of explanatory documents.

861. No part of the operational control systems can be outsourced to an entity that is not registered with the JFSA who maintain the power to supervise and enforce compliance with the relevant requirements. The same applies to outsourcing of the requirements in relation to record keeping, explanatory documents, and rating policy. There is also a need to ensure that the system developed is appropriate for each single credit rating agency. A credit rating agency has to ensure that it meets all requirements of establishing an operational control system and thus is ultimately responsible for tasks outsourced to other units within the same group of credit rating agencies. Hence, CESR has no concern about this .

III – Confidentiality

862. CESR considers this area is covered in the Japanese regulatory regime, although the requirements are less detailed.

IV – Record keeping

863. The Japanese framework has comprehensive record keeping requirements.

E. Quality of methodologies and quality of ratings

864. Within this section the EU Commission required CESR to assess at least the following criteria:

Extract from the mandate

- Competent authorities do not interfere with the content of ratings or the CRAs methodologies.
- A CRA has a function devoted to the periodical review of methodologies and models (review function).
- A CRA applies consistently the changes in methodologies and models to existing ratings.
- A CRA monitors its ratings and methodologies on an on-going basis and at least annually.
- A stringent rotation policy is in put in place (lead rating analysts to rotate client at least every 4 years).

865. In addition to the above, CESR's approach to assessing the equivalence of the quality of rating and of methodologies requirements in the EU Regulation is as set out in paragraphs **147** to **171** above, and for the purposes of discussion has grouped these requirements into the following sections as follows:

a) Reviewing credit ratings, methodologies, models, assumptions and information used in issuing ratings;
b) Knowledge and experience of employees directly involved in credit rating activities;
c) Quality of credit ratings and analysis of information used in assigning credit ratings;
d) Quality of methodologies and changes to them; and
e) Competition.

866. As explained in paragraph **147** above, CESR considers that these requirements support achieving the following objectives:

a) that the methodologies, models and key rating assumptions that are used in credit rating activities are rigorous, continuous and thorough;
b) the adequate quality, integrity and thoroughness of the credit rating activities;
c) as set out in recital 7 of the EU Regulation The protection of the stability of financial markets and of investors;
d) that ratings and methodologies are subject to validation as well as the adequate quality and thoroughness of ratings.

Japanese approach to quality of methodologies and quality of ratings

867. The overall approach towards quality of methodologies and of credit ratings in Japan is pretty similar to that of the EU in terms of having prescriptive requirements set out in their laws, Cabinet Office Ordinances and Guidelines.

868. The requirements that Japan has in relation to these provisions of the EU Regulation are based on:

a) Minimum requirements that the "ratings determination policy" and the "ratings provision policy" shall satisfy;[65]

b) The obligation for credit rating agencies to establish operational control systems for the fair and appropriate performance of their credit rating business in order to conduct their activities with fairness and adequacy (which is one of the four pillars of the Japanese Framework)[66].

869. The Guidelines on this issue set out that in examining the operational control systems established by a credit rating agency, the supervisory departments shall take into consideration whether the depth and level of such systems are appropriate to the characteristics, size, complexity and other attributes of the credit rating agency's business.[67]

870. In addition, the supervisory departments shall consider whether officers and employees of the credit rating agency are adequately informed about the operational control systems, and that the validity and effectiveness of these systems are subject to proper examination and revised as needed.

871. Namely, Section III-2-1 of the Guidelines provides that:

"…Furthermore, in addition to internal rules, etc. being properly developed, in order for an operational control system that is based on the spirit of the law to be established, there needs to be conditions and systems in place whereby, more than just formulating, revising and issuing notifications about the system, there is reliable dissemination and promulgation to officers and employees by way of training and other means. Moreover, in order to ensure the effectiveness of the operational control system, in addition to the internal checks and balances function of internal audits and so forth being adequately demonstrated, there also needs to be conditions and systems in place whereby the internal rules, etc. can be revised as needed based on examinations of the validity and effectiveness of the operational control system."

872. Credit rating agencies that conduct business as a group are, under certain conditions[68], permitted to jointly develop an operational control system as a group, provided that no part of the system is assigned to an unregistered entity.

873. Namely, Section III-2-1 of the Guidelines provides that:

"…no part of the operational control system can be assigned to an unregistered business operator even if it is a credit rating agency within a group. For example, in cases where the rating determination policy, etc. (the policies and methods relating to the determination of credit ratings; the same shall apply hereinafter), which were formulated by an unregistered business operator within the group, are used "as is" by a credit rating agency, and where that credit rating agency does not have the authority to make revisions themselves, then it should be kept in mind that it may not be found that the said credit rating agency has taken sufficient measures for putting in place functions to properly examine the validity and effectiveness of rating determination policy, etc."

874. The system developed as a group must, in any case, be appropriate in view of the characteristics, size, complexity and other attributes of the business conducted by each individual credit rating agency and there also needs to be appropriate cooperation between the board of directors of each credit rating agency to properly discharge their responsibilities.[69]

65 Article 66-36 of the Act and Article 313 of the COOFIN.
66 Article 66-32 and Article 66-33 of the Act.
67 Section III-2-1 of the Guidelines.
68 Article 306(5) of the COOFIN.
69 Section III-2-1 of the Guidelines.

875. As discussed below in paragraph **883** below, a credit rating agency is required to provide information to the JFSA regarding its operational control systems as part of the registration process. In case of changes to the information provided, a credit rating agency needs to submit without delay to the JFSA a written notification stating the particulars and date of and the reasons for the change.[70]

876. In addition, information about the operational control systems implemented by the credit rating agency needs to be disclosed to the public in the explanatory documents (discussed below) that need to be prepared and published for each business year.[71]

How the Japanese requirements meet the objectives of these requirements

(1) Reviewing credit ratings, methodologies, models, assumptions and information used in issuing ratings

877. The EU requirements in respect of reviewing credit ratings, methodologies, assumptions and information used in issuing ratings are as set out in paragraph **150** above:

a) to have a review function devoted to the periodical review of methodologies, models and key rating assumptions;
b) to monitor its ratings and methodologies on an on-going basis and at least annually; and
c) to review the affected credit ratings as soon as possible and not later than within 6 months after the change, and in the meantime place those ratings under observation.

878. For the purposes of assessing equivalence in relation to this set of requirements, CESR considers, as set out in paragraph **151** above, that, as a minimum, there need to be requirements in place aimed at ensuring that methodologies and credit ratings are up-to-date and subject to a comprehensive review on a periodic basis.

a) Review function

879. As indicated in paragraph **152** above, for the purposes of assessing the equivalence of a third country, CESR may accept that there is no requirement to have a separate review function per se, provided that requirements are in place that achieve the objective of a periodic review of methodologies, models, and key rating assumptions by those who are independent from those that are responsible for the development and use of these methodologies, models and key rating assumptions.

880. In Japan, credit rating agencies are required to establish operational control systems for the fair and appropriate performance of the credit rating business, that overall achieve the objective of a periodic review of methodologies, models and key rating assumptions.

881. These operational control systems must include:

a) measures for the performance of the credit rating business in accordance with the rating policy;[72]

b) "measures to put in place the functions to properly verify the appropriateness and effectiveness of the rating determination policy (including the appropriateness and effectiveness of the rating

70 Article 66-31(3) of the Act and Article 305 of the COOFIN.
71 Article 66-39 of the Act and Article 318(iii) of the COOFIN.
72 Article 66-33 of the Act; Article 306(1) (xiv) of the COOFIN.

determination policy for asset securitization products in cases where there has been a change in the characteristics of the credit status of the assets underlying the said asset securitization products)";[73]

c) measures to verify the credit rating agency's ability in determining a credit rating for asset securitisation products in an appropriate manner, in cases where the design of said asset securitization products substantially deviates from those to which it determined credit ratings in the past.[74]

882. Upon further clarification with the staff of the JFSA regarding this provision CESR understands that the measures indicated above require a review function tasked with a periodical review of methodologies, models and key rating assumptions from an independent standpoint. Although there is no an express requirement for the review function to be independent from the business lines responsible for the credit rating activities, CESR points out that this function is part of the operational control systems, the measures of which have to ensure the credit rating agency shall always maintain a fair and unbiased stance in order to perform its credit rating activities in accordance with Article 66-32 of the Act.

883. Details of the measures referred to in paragraph **881**, letters **b)** and **c)** above, are to be provided to the JFSA as part of the registration form.[75] In case of changes, a credit rating agency needs to notify the JFSA without delay, stating the date and the reasons for the change.[76]

884. The same information is to be disclosed by the credit rating agency in the explanatory documents to be prepared for each business year and published on the website or by other means that ensure easy inspection by investors and other credit rating users.[77]

885. The Guidelines set out the approach that will be taken by the supervisory departments in examining the measures indicated above.

886. Namely, Section III-2-1(13)(ii) of the Guidelines provides that, in examining the measures put in place to ensure the effectiveness of compliance with the rating policy, the supervisory departments would take into account:

"…whether there is a system in place for the internal checks and balances function of internal audits and so forth to be adequately demonstrated".

887. In examining how credit rating agencies have developed the measures to properly verify the appropriateness and effectiveness of their rating determination policy, the supervisory departments shall consider:

"(a) Whether the credit rating agency has properly established a policy and procedures for examining the validity and effectiveness of rating determination policy, etc., and whether it appropriately examines them in accordance with that policy and procedures. Also, whether the credit rating agency examines the validity and effectiveness of the policy and procedures in a timely and appropriate manner, and makes revisions as necessary.

(b) Whether the credit rating agency has clearly established in advance the criteria for what cases correspond to "cases where there has been a change in the characteristics of the credit status of the

73 Article 66-33 of the Act; Article 306 (1)(vi)(d) of the COOFIN.
74 Article 66-33 of the Act; Article 306 (1)(vi)(f) of the COOFIN.
75 Article 66-28(2)(ii) of the Act and Article 299(xvii); Article 299(xix) of the COOFIN.
76 Article 66-31(3) of the Act and Article 305 of the COOFIN.
77 Article 66-39 of the Act; Article 318(iii)(d)(4) and Article 318(iii)(d)(6) of the COOFIN.

assets underlying the asset securitization products," and whether it appropriately examines the validity and effectiveness of rating determination policy, etc. for asset securitization products. Also, whether, in view of market trends and the characteristics of the asset securitization products, the credit rating agency examines the validity of the said criteria in a timely and appropriate manner, and makes revisions as necessary."[78]

888. In addition, according to Article 306(1)(vi)(a) of the COOFIN, credit rating agencies need, as part of their operational control systems to manage the quality of the rating determination process, to implement measures to retain staff with the expert knowledge and skills which enable them to perform appropriately and smoothly the credit rating activities.

889. Section III-2-1 (5)(i)(d) of the Guidelines point out that, for these purposes, credit rating agencies are expected to appoint an individual who is responsible for supervising credit rating analysts in the process pertaining to the determination of credit ratings.

890. According to Article 299(xiv) and Article 300(iv) of the COOFIN, a credit rating agency also needs to provide to the JFSA, as part of the registration process, the details of the person responsible for supervising credit rating analysts and information on the method of its appointment.

891. In order to ensure the implementation of the measures referred to in paragraphs **881** and paragraphs **888** and **889** above (and other measures to be established as part of the operational control systems), a credit rating agency is required to set up a Supervisory Committee composed of one-third or more of independent members, as discussed in paragraph **503** above[79].

892. However, the Commissioner of the JFSA may approve an exemption from the application of the requirement to establish a Supervisory Committee under Articles 306(3) and 306(4) of the COOFIN. The approval of the exemption is subject to several conditions, including the implementation of alternative measures that would enable the credit rating agency to implement properly the aforesaid operational control systems.

893. In addition an exemption from the application of the requirements to set up a Supervisory Committee may be granted by the Commissioner of the JFSA to a foreign credit rating agency under Articles 306(6) and 306(7) of the COOFIN, provided, among other things, that the foreign credit rating agency is deemed to perform its business fairly and adequately by taking other alternative measures, and that the said credit rating agency is subject to appropriate supervision by the foreign relevant regulator "administrative organ".

894. In assessing the grounds for the exemption for a foreign credit rating agency under Article 306(6) of the COOFIN, the supervisory department shall take into account:

"Whether the credit rating agency has built solid governance for ensuring appropriateness of business by having a consultative body, which includes outside directors and other external persons, examine the appropriateness of the operational control system[80]*."*

895. Following the approval of exemption, in such cases as where a problem is found in the execution of the alternative measures, the supervisory departments shall consider necessary actions, including the rescission of approval based on Article 306(8) of the COOFIN.[81]

78 Section III-2-1 (5)(iv) of the Guidelines.
79 Article 66-33 of the Act; Article 306(1) (xvii) of the COOFIN.
80 Section III-3-3(5) of the Guidelines.
81 Section III-3-3 of the Guidelines.

b) Monitoring of methodologies and credit ratings on an ongoing basis and at least annually

- **Monitoring of methodologies on an on-going basis and at least annually**

896. The measures that need to be put in place by a credit rating agency to monitor the methodologies used to determine credit ratings have been discussed in paragraph **881** above.

897. As indicated in paragraph **887**, in examining these measures, the supervisory departments need to take into consideration:

a) whether a credit rating agency has properly established (and does monitor in a timely and appropriate manner) policy and procedures for examining the validity and effectiveness of the rating determination policy;

b) whether the credit rating agency appropriately examines its rating determination policy in accordance with that policy and procedures.

898. CESR understands following further clarification from the staff of the JFSA on this issue that, irrespective of the lack of any specific provision to this effect, for these policies and procedures to be considered as properly established, there is a reasonable expectation that a credit rating agency will need to provide for the monitoring of the methodologies on an on-going basis and at least annually.

- **Monitoring of credit ratings on an on-going basis and at least annually**

899. The Japanese framework requires that a credit rating agency establishes operational control systems that include measures for the formulation and enforcement of policies on managing the quality of its credit ratings determination process[82].

900. This needs to include, among other things, measures that allow for an appropriate monitoring of credit ratings on an on-going basis:

"the measures so that the Credit Rating Agency will be able to implement the verification and updating of a Credit Rating already determined, in an appropriate manner and on an ongoing basis".[83]

901. In cases where a credit rating agency has decided not to implement the said verification or updating (which CESR understands to mean following further clarification from the staff of the JFSA that the credit rating agency has decided to discontinue the rating), the operational control systems shall include measures to announce, without delay, such fact and any other necessary information.[84]

902. The Supervisory Committee is required to ensure the implementation of the measures referred to in paragraphs **900** and **901** above.

903. A credit rating agency is required to provide details of these measures to the JFSA as part of the registration process[85] and to notify the authority without delay in case of changes to it[86].

82 Article 66-33(1) of the Act and Article 306(1)(vi) of the COOFIN.
83 Article 66-33(1) of the Act and Article 306(1)(vi)(g) of the COOFIN.
84 Article 66-33(1) of the Act and Article 306(1)(vi)(g) of COOFIN.
85 Article 66-28(2)(ii) of the Act and Article 299(xx) of the COOFIN.
86 Article 66-31(3) of the Act and Article 305 of the COOFIN.

904. In addition, information on the measures implemented to verify and update credit ratings in an appropriate manner and on an-going basis is to be provided in the explanatory documents that need to be prepared and published by a credit rating agency for each business year[87].

905. In examining how credit rating agencies have developed the aforesaid measures, the Guidelines explain that the supervisory departments need to consider whether credit ratings are subject to an appropriate and continuous examination and update, and whether the relevant policies and procedures are monitored in a timely manner and revised as necessary.

906. Namely, Section III-2-1 (5)(vii) of the Guidelines provides that the supervisory departments shall take into consideration:

"Whether the credit rating agency has properly established a policy and procedures pertaining to the examination and update of determined credit ratings, and whether it appropriately and continuously conducts examinations and updates in accordance with the policy and procedures. Also, whether the credit rating agency examines the validity and effectiveness of the policy and procedures in a timely and appropriate manner, and makes revisions as necessary".

c) Review affected ratings as soon as possible and not later than within 6 months after the change, and in the meantime place those ratings under observation

907. As indicated in the JFSA's staff answer to Q21h, while a credit rating agency is required to review the affected credit ratings in case of changes in its rating determination policy, it will be left to the credit rating agency itself to determine how long such exercise would take.

908. The credit rating agency is required to take measures:

a) to publish without delay the range of potentially impacted credit ratings (that call for judgment on whether to update or not), as well as the period necessary for updating; and

b) to conduct the necessary updates in the aforesaid period.

909. Namely, Article 306(1)(vi)(e) of the COOFIN provides that the operational control systems required to be established by a credit rating agency shall include:

"the measures to be implemented in cases of any material amendment to the Rating Determination Policy, etc., if any, so as to announce, without delay, the scope of Credit Ratings already determined in accordance with the former Rating Determination Policy, etc. but which require further consideration as to the necessity of being updated in accordance with the amended Rating Determination Policy, etc. and the period of time required for such updating, as well as to update the Credit Ratings within such period of time."

910. The details of such measures need to be included in the credit rating agency's registration form,[88] with an obligation to notify the JFSA without delay in case of any changes to the measures.[89]

911. In addition, a description of these measures needs to be provided in the explanatory documents to be prepared and published by a credit rating agency for each business year.[90]

912. Section III-2-1 (5)(v)(a)(b) of the Guidelines provides that, in examining the measures pertaining to the update of credit ratings that have been determined based on rating determination policy, in

87 Article 66-39 of the Act; Article 318(iii)(d)(7) of the COOFIN.
88 Article 66-28(2)(ii) of the Act; Article 299(xviii) of the COOFIN.
89 Article 66-31(3) of the Act; Article 305 of the COOFIN.
90 Article 66-39 of the Act; Article 318(iii)(d)(5) of the COOFIN.

cases where there have been important changes in the said rating determination policy, the supervisory departments shall consider:

"(a) Whether the credit rating agency has clearly established in advance the criteria for what cases correspond to "important changes," and whether it appropriately determines the necessity for updating credit ratings. Also, whether, in view of market trends and the characteristics of the asset securitization products, the credit rating agency examines the validity of the said criteria in a timely and appropriate manner, and makes revisions as necessary.

(b) Whether the credit rating agency has properly established a policy and procedures pertaining to the update of credit ratings, and whether it conducts updates appropriately in accordance with that policy and procedures. Also, whether the credit rating agency examines the validity and effectiveness of the policy and procedures in a timely and appropriate manner, and makes revisions as necessary".

913. In light of the above, CESR notes that the requirement in Japan is even stricter than that sets out in Article 8(6)(b) of the EU Regulation, since the identification of credit ratings that are based on the former methodology and need to be put under observation must be carried out without delay, and not "as soon as possible but not later than 6 months after the change". In addition, the credit rating agency is required to immediately announce not only the likely scope of ratings potentially impacted, but also the time within which credit rating will be updated, and update the ratings within this stated period.

Box 34

Reviewing credit ratings, methodologies, models assumptions and information used in issuing ratings

914. CESR considers that the objectives of these EU requirements are met.

915. Although there is not a specific requirement for the review function to be independent from the business lines responsible for the credit rating activities, CESR understands following additional clarification on this point from the staff of the JFSA that there is a need to appoint a specific review function. CESR considers that there are requirements in place that overall achieve the objective of a periodic review of methodologies, models and key rating assumptions from an independent standpoint. Namely, a credit rating agency is required to adopt measures for the performance of the credit rating business in accordance with its rating policy as well as measures to properly verify the appropriateness and effectiveness of its rating determination policy to ensure that a fair and unbiased stance is maintained in the performance of the credit rating activities.

916. In addition, a credit rating agency is required to appoint a person responsible for supervising credit rating analysts in the process pertaining to the determination of credit ratings.

917. CESR understands following further clarification from the staff of the JFSA on this issue, that irrespective of the lack of any specific provision to this effect, for these policies and procedures to be considered as properly established, there is a reasonable expectation that a credit rating agency will need to provide for the monitoring of the methodologies on an on-going basis and at least annually.

918. A credit rating agency is required to implement measures that allow for an appropriate monitoring of credit ratings on an on-going basis.

919. A credit rating agency is required: (i) to adopt measures to publish without delay the range of credit ratings potentially impacted by material amendments to its rating determination policy as

well as the period necessary for updating, and (ii) to conduct the necessary updates in the stated period.

920. The Supervisory Committee, composed for one-third or more by independent members, is responsible for ensuring that the above-mentioned measures are implemented.

(2) *Knowledge and experience of employees directly involved in credit rating activities*

921. The EU requirements in relation to this section, as discussed in paragraph **154** above, are that the credit rating agency shall ensure that rating analysts, employees of the credit rating agency and any other natural person directly involved in credit rating activities have appropriate knowledge and experience for the duties assigned.

922. As set out in paragraph **158,** in relation to this set of requirements, CESR considers that, for the purpose of equivalence, it is important that those involved in credit rating activities have the necessary skills and knowledge to carry out their respective responsibilities and that this is an area that needs to be covered in the relevant third country regulatory framework.

923. As indicated in the JFSA's staff answer to Q13 and is discussed in paragraphs **583** and **811** above, in Japan, overall the provisions are very comprehensive in this area and a credit rating agency needs to ensure that it adequately assigns staff with sufficient expertise and skills to the credit rating activities.[91]

924. In the accompanying documents of an application form, a credit rating agency is required to describe:

a) the policies for the recruitment of employees (excluding rating analysts);
b) The policies on the recruitment and training of rating analysts;
c) the assignment of duties among rating analysts;
d) the method of the appointment of members of the committee which makes the final decision for determining a credit rating, and the methods for the decision-making of such committee;
e) the method of the appointment of a person responsible for supervising rating analysts in the process of determining credit ratings and details of such person.[92]

925. In case of changes to the information provided in the registration form, a credit rating agency is required to notify the JFSA without delay of the change.[93]

926. In addition to the above, measures are to be taken to ensure that the credit rating agency' analysts have sufficient knowledge and experiences and to prevent credit ratings from being determined, in cases where personnel with expertise and skills cannot be sufficiently secured.

927. Namely, Articles 306(1)(iii), 306(1)(vi)(a) and 306(1)(vi)(c) of the COOFIN require credit rating agencies to establish, as part of their operational control systems, measures so as:

- *"not to recruit any person about whom serious questions might be raised as to his/her competency in performing Credit Rating Activities in a fair manner;*

- *to retain sufficient staffs with the expert knowledge and skills which enable them to implement appropriately and smoothly the operation of the Credit Rating Business (in cases where its final decision as a Credit Rating Agency in determining a Credit Rating is to be made by a resolution*

91 Article 66-33(2) of the Act.
92 Article 66-28(2)(ii) of the Act; Article 299(vi), (xi), (xii), (xiii) and (xiv) and Article 300(iv) of the COOFIN.
93 Article 66-31(3) of the Act; Article 305 of the COOFIN.

of the council, the method of the appointment of the council members, the decision-making process of such council, and any other measures so as to ensure that employees can exercise their expert knowledge and skills in an appropriate manner shall also be included);

- *to refrain from determining a Credit Rating, in cases where the Credit Rating Agency is unable to secure sufficient staff with expert knowledge and skills for determining a Credit Rating, or in cases where it is unable to secure a sufficient quality of the information it uses for determining a Credit Rating."*

928. The approach to be taken by the supervisory departments in examining these measures is set out in the Guidelines.

929. Namely, the supervisory departments shall take into consideration:

- *"Whether the credit rating agency has properly established a policy for the appointment and training of credit rating analysts so that it can secure sufficient persons who have expert knowledge and skills and who can conduct credit rating business appropriately and smoothly, and whether it is making appointments and conducting training appropriately in accordance with that policy. Also, whether the credit rating agency examines the validity and effectiveness of the said policy in a timely and appropriate manner, and makes revisions as necessary;*

- *Whether the credit rating agency has appropriately assigned the necessary number of credit rating analysts to conduct credit rating business appropriately and smoothly.*

- *Whether the credit rating agency has clearly established the authority and responsibility of the credit rating committee, and whether it has properly established the process for appointing committee members, the process by which the credit rating committee will make decisions and other procedures pertaining to the administration of the committee. Also, whether the credit rating committee is functioning effectively, such as whether it is appropriately exercising its invested authority.*

- *Whether the credit rating agency has clearly established the authority and responsibility of the person who is responsible for supervising credit rating analysts in the process pertaining to the determination of credit ratings, and whether it has properly established the process for appointing such a person. Also, whether the person who is responsible for supervising credit rating analysts is functioning effectively, such as whether he/she is appropriately exercising his/her invested authority.*

- *Whether the credit rating agency has properly established a policy for the employment of officers and employees so that it can employ persons who have the necessary abilities and experience and required professional ethics to conduct credit rating activities fairly, and whether it is making appointments appropriately in accordance with that policy. Also, whether the credit rating agency examines the validity and effectiveness of the said policy in a timely and appropriate manner, and makes revisions as necessary."*[94]

930. In addition, a credit rating agency needs to disclose information about its policy for the recruitment and training of rating analysts and the allocation of the rating analysts in the explanatory documents that need to be prepared and published for each business year.[95]

Box 35

94 Section III-2-1 (5)(1) from (a) to (d) and Section III-2-1 (2) of the Guidelines.

95 Article 66-39 of the Act; Article 318(iii)(d)(1) and Article 318(iii)(d)(2) of the COOFIN. The business report to be prepared and submitted on an annual basis to the JFSA under Article 66-38 of the Act needs also to contain information on the total number of officers and employees and on the status of rating analysts, as set out in Article 316(1) and Appended Form No 28 of the COOFIN.

Knowledge and experience of employees directly involved in credit rating activities

931. CESR considers that the Japanese requirements are very comprehensive in this area and achieve the objective of the EU provision to ensure that those directly involved in credit rating activities have sufficient knowledge and experience.

(3) *Quality of credit ratings and analysis of information used in assigning credit ratings*

932. As set out in paragraph **161** above, the EU Regulation sets out a number of requirements dealing with quality of credit ratings and analysis of information used in assigning credit ratings:

a) to adopt, implement and enforce adequate measures to ensure that the credit ratings issued by credit rating agencies are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies;
b) to adopt all necessary measures so that the information they use in assigning a credit rating is of sufficient quality and from reliable sources;
c) to establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings;
d) to inform the entity subject to the rating at least 12 hours before publication of the credit rating and of the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors;
e) to refrain from issuing a credit rating or withdraw an existing rating if they do not have sufficient quality information to base their ratings on;
f) to establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

933. These requirements are aimed at ensuring that ratings being issued are robust, well founded and based on reliable information and overall are of adequate quality.

a) Adopt, implement and enforce measures to ensure that credit ratings issued are based on a thorough analysis of all information that is available, and is relevant to their analysis according to rating methodologies

934. In Japan, credit rating agencies are required to adopt policies for the determination of their credit ratings that provide for a comprehensive analysis of all relevant information collected.

935. Namely, Article 313(2)(ii) of the COOFIN states that the "rating determination policy" shall satisfy, among other, the following requirement:

"that it provides that, for the purpose of making a judgment, any and all collected information pertaining to the credit status of financial instruments and juridical persons (limited to the cases where the object of the Credit Rating is the assessment of such credit status) shall be comprehensively taken into account".

936. The "rating determination policy" needs to be disclosed in a manner which allows easy inspection by investors and credit rating users at any time, by means of the use of the Internet or any other means[96].

96 Article 314(1) of the COOFIN.

937. In cases where a credit rating agency intends to effect any material change to its "rating determination policy", it shall, in advance, announce the fact that the change will be effected and provide an outline of such change. However, if any unavoidable ground exists, such unavoidable ground, the fact of the change and an outline thereof needs to be announced without delay after the change.[97]

938. An outline of the "rating determination policy" needs also to be included in the explanatory documents that a credit rating agency is required to prepare and publish for each business year.[98]

939. There is also a requirement to publicly disclose, on a rating-by-rating basis, an outline of the information used in determining the credit rating, the provider of said information and an outline of the measures implemented for the purposes of the quality assurance of the said information.[99]

b) Adopt measures so that the information used in assigning a credit rating is of sufficient quality and from a reliable source

940. The operational control systems to be implemented by credit rating agencies need to include measures so that information they use in assigning a credit rating is of sufficient quality.

941. This requirement is set out in Article 306(1)(vi)(b) of the COOFIN which states that the operational control systems shall satisfy, among other things, the following requirement:

"(vi) that the following measures for the formulation and enforcement of policies on managing the quality of the Credit Rating determining process have been implemented:
(b) the measures to ensure that the information used in determining a Credit Rating is of sufficient quality".

942. CESR understands following additional clarification on this point from the staff of the JFSA that, irrespective of the lack of any specific provision to this effect, in order to ensure that the information used in determining a credit rating is of sufficient quality, the aforesaid measures should require to use information from reliable sources.

943. In examining these measures, the Guidelines on this issue explain that the supervisory departments need to take into consideration:

"Whether the credit rating agency has properly established a policy and procedures for ensuring the quality of information provided by rating stakeholders for the purpose of determining a credit rating, and whether it examines the information appropriately in accordance with that policy and procedures. Also, whether the credit rating agency examines the validity and effectiveness of the policy and procedures in a timely and appropriate manner, and makes revisions as necessary."[100]

944. Details of the measures to be implemented so that the information used for determining credit ratings is of sufficient quality are to be provided to the JFSA as part of the registration process[101], with an obligation to notify the JFSA in case of changes[102] to the measures.

945. A description of the measures is to be disclosed to the public in the explanatory documents that need to be prepared and published by the credit rating agency for each business year[103].

97 Article 314(3) of the COOFIN.
98 Article 66-39 of the Act and Article 318(iv) of the COOFIN.
99 Article 313(3)(iii)(j) of the COOFIN.
100 Section III-2-1 (5) (ii) of the Guidelines.
101 Article 66-28(2)(ii) of the Act; Article 299(xv) of the COOFIN.
102 Article 66-31(3) of the Act; Article 305 of the COOFIN.
103 Article 66-39 of the Act; Article 318(iii)(d)(3) of the COOFIN.

946. In addition, as indicated by the JFSA staff in its answer to Q21b, Article 313(3)(iii)(j) of the COOFIN promotes voluntary efforts for ensuring the information quality by requiring a credit rating agency to disclose to investors, when providing individual credit ratings:

a) an outline of the principal information used in determining a credit rating,
b) an outline of the measures implemented for the purposes of the quality assurance of the said information, and
c) the provider of the said information.

c) Establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings

947. As indicated in paragraph **164** above, for the purposes of equivalence, CESR may accept that a third country legal and regulatory framework does not contain a separate requirement for a credit rating agency to monitor the impact of changes in macroeconomic or of financial market conditions on credit ratings, provided this is covered by the obligation to ensure that credit ratings are based on accurate and up-to-date information.

948. As indicated in paragraphs **899** to **906** above, in Japan, there is a requirement to implement measures to verify and update credit ratings in an appropriate manner and on an ongoing basis.

949. CESR understands following additional clarification on this point from the staff of the JFSA that irrespective of the lack of any specific provision to this effect, these measures are expected to include also internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings.

d) Inform the entity subject to the rating at least 12 hours before publication of the credit rating of the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors

950. In Japan, credit rating agencies are required to provide rating stakeholders with credit ratings in advance so as to enable them to check if there are factual errors or not.

951. This requirement is set out in Article 313(2)(iv) of the COOFIN which provides that the "credit determination policy" shall satisfy among other things the following requirement:

"that it provides for the policies and methods which enable a Rating Stakeholder, in advance of providing to someone or making available to the public the determined Credit Rating, to verify whether there was any factual misperception as to the principal information used by the Credit Rating Agency in determining the Credit Rating".

952. This needs to include policies and methods for securing a reasonable length of time which allows the rating stakeholder to express its opinion[104].

953. However, there is no explicit requirement for the rated entity to be informed at least 12 hours before publication of the credit rating. As indicated by the JFSA in the answer to Q24, "the minimum time for the provision of credit ratings is not specified. Concern would be rather greater for the potential problems which may occur from retaining material non-public information in the hands of a rating stakeholder."

104 Article 66-36(1) of the Act; Article 313(2)(iv) of the COOFIN.

954. The Guidelines on this issue explain that with respect to the policies and methods referred to in paragraph **951** above, the supervisory departments would take into consideration:

"….whether the credit rating agency has clearly and appropriately stated, not only the policies and processes for ensuring a reasonable amount of time needed for the said rating stakeholder to express his/her opinions, but also the handling of instances where time is needed to check whether there are any factual errors."[105]

955. A description of the aforesaid policies and methods needs to be provided to the JFSA as part of the registration process[106], with an obligation to notify the authority in case of changes to them[107].

956. An outline of the "rating determination policy" also needs to be included in the explanatory documents that a credit rating agency is required to prepare and publish for each business year[108].

957. In addition, there is also a requirement for a credit rating agency to publicly disclose, on a rating-by-rating basis, an outline of the measures implemented for the purposes of the quality assurance of the principal information used in determining credit ratings.[109]

e) Refrain from issue a credit rating or withdraw an existing rating if it does not have sufficient quality information to base its ratings on

958. As part of its organisational control systems, the Japanese require a credit rating agency to implement measures preventing the issuing of a credit rating if it does not have sufficient quality information on which to base its rating on.

959. This requirement is set out in Article 306(1)(vi)(c) of the COOFIN which provides that:

"(1) The operational control systems required to be established by a Credit Rating Agency pursuant to the provision of Article 66-33, paragraph (1) of the Act shall satisfy the following requirements:
(vi) that the following measures for the formulation and enforcement of policies on managing the quality of the Credit Rating determining process have been implemented:
(c) the measures to refrain from determining a Credit Rating, in cases where the Credit Rating Agency is unable to secure sufficient staff with expert knowledge and skills for determining a Credit Rating, or ***in cases where it is unable to secure a sufficient quality of the information it uses for determining a Credit Rating.****"*

960. CESR understands following further clarification of this issue from the staff of the JFSA that the above measures do not explicitly require that credit ratings are withdrawn if a credit rating agency does not have sufficient quality information to base its ratings on, but that this is achieved by virtue of the fact that if the credit rating agency does not have sufficient quality of information in order to update the rating, that the rating can not be updated and as such in practice will have to be withdrawn.

961. In examining these measures, the Guidelines on this issue explain that the supervisory departments would take the following into account:

"Whether, in determining a credit rating, the credit rating agency appropriately examines if personnel having expert knowledge and skills have been sufficiently secured, and if the quality of the information used in determining the credit rating has been sufficiently ensured, and whether there is a

105 Section III-2-3(1)(v) of the Guidelines.
106 Article 66-28(2)(ii) of the Act; Article 299(xxxvi)(b) of the COOFIN.
107 Article 66-31(3) of the Act and Article 305 of the COOFIN.
108 Article 66-39 of the Act and Article 318(iv) of the COOFIN.
109 Article 313(3)(iii)(j) of the COOFIN.

system in place to prevent credit ratings from being determined when either of these cannot be adequately guaranteed. Also, whether the credit rating agency examines the validity and effectiveness of the said system in a timely and appropriate manner, and makes revisions as necessary."[110]

962. The details of these measures need to be provided to the JFSA as part of the registration process,[111] with an obligation to notify the authority in case of changes to them.[112]

963. In addition, as explained in paragraph **946** above, Article 313(3)(iii)(j) of the COOFIN promotes voluntary efforts for ensuring the quality of the information by requiring a credit rating agency to disclose to investors, when providing individual credit ratings, an outline of the measures implemented for the purposes of the quality assurance of the said information.

(f) Establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings

964. As indicated in the answer to Q16, in order to ensure that the executives and employees of a credit rating agency perform their businesses from an independent standpoint, with fairness and integrity, either of the following rotation options need be taken:

a) rotation of lead analysts (five years with an interval of two years); or

b) making final decisions on credit ratings at the rating committee, while preventing at least one-third of the total members of the said committee from being successively involved in processes pertaining to the determination of credit ratings of the same rated entity.

965. This requirement is set out in Article 306(1)(ii) of the COOFIN which provides that the operational control systems that need to be established by a credit rating agency need to satisfy, among other things , the following requirements:

"(ii) that any of the following measures has been implemented, so that a Person in Charge of Rating, as a party independent from Rating Stakeholders, fairly and faithfully carries out the business, in cases where such Person in Charge of Rating participates consecutively in the processes of determining Credit Ratings of the matters in which the same Rating Stakeholder has an interest:

(a) measures to be implemented so that, in cases where any Lead Rating Analyst participating in the process of determining a Credit Rating had, for five consecutive years, participated in the process of determining a Credit Rating of the matter in which the same Rating Stakeholder has an interest, such Lead Rating Analyst would refrain from participating in the process of determining a Credit Rating of the matter in which the same Rating Stakeholder has an interest for two subsequent years thereafter;

(b) measures to ensure that the final decision as a Credit Rating Agency in determining a Credit Rating shall be made by a resolution of the council; and measures so that one third or more of the total of the council members would not participate consecutively in the processes of determining Credit Ratings for the matter in which the same Rating Stakeholders has an interest (in cases where the object of the Credit Rating is the assessment of the credit status of any subject other than Asset Securitization Products, and where two or more Credit Ratings with the same object were determined in the same business year, such two or more Credit Ratings shall be deemed to be a single Credit Rating)".

110 Section III-2-1 (5)(iii) of the Guidelines.
111 Article 299(xvi) of the COOFIN.
112 Article 66-31(3) of the Act and Article 305 of the COOFIN.

966. In examining the rotation rules implemented by a credit rating agency, the Guidelines explain that supervisory departments would take the following into account:

"(i) Whether the credit rating agency has clearly established in advance whether it will use both or select one of either of the measures prescribed in Article 306(1)(ii)(A) or (B) of the FIB Cabinet Office Ordinance (and the application criteria of each measure in cases where it uses both).

(ii) Whether the credit rating agency has properly recorded and stored credit ratings in which a lead rating analyst or a member of the credit rating committee (refers to the consultative body which makes the final decision for the credit rating agency regarding the determination of credit ratings; the same shall apply hereinafter) has been involved in the rating process, so that it can properly adhere to the measures prescribed in Article 306(1)(ii)(A) or (B) of the FIB Cabinet Office Ordinance".[113]

967. The details of the rotation measures that need to be implemented by the credit rating agency are to be provided to the JFSA as part of the registration process[114], with an obligation to notify the authority in case of changes to them.[115]

968. In addition, a credit rating agency is required to include in the explanatory documents prepared and published for each business year, information regarding the status of organising its operational control systems, including:

"the *measures so that a person in charge of rating, as a party independent of a Rating Stakeholder, fairly and faithfully carries out the business, even in cases where such Person in Charge of Rating participates consecutively in the processes of determining Credit Ratings of the matter in which the same Rating Stakeholder has an interest"*[116].

969. As discussed in paragraphs **467** et seq. above, an exemption from the application of the rotation rules might be approved by the JFSA.

970. This is provided by Article 306(2) of the COOFIN which provides that the rotation requirements:

"shall not apply in the case where, taking into account the number of Officers and employees of the Credit Rating Agency, the nature, size, and complexity of the Credit Rating Business and any other circumstances, the Credit Rating Agency is found to have difficulty in complying with said provision, and where it is found that implementation of any alternative measures would enable its Officers and employees to carry out its business independently from the Rating Stakeholder and in a fair and faithful manner, provided that approval from the Commissioner of the Financial Services Agency shall be obtained."

971. Article 306(6) of the COOFIN provides that the rotation rules:

"shall not apply to cases where the Credit Rating Agencies (limited to a foreign juridical person; hereinafter the same shall apply in this paragraph and the following paragraph) are deemed to perform their business fairly and adequately by taking other alternative measures and the said Credit Rating Agencies are subject to appropriate supervision by the Foreign Administrative Organ, etc. on the proper functioning of such alternative measures for the fair and adequate implementation of business, provided that approval from the Commissioner of the Financial Services Agency shall be obtained."

113 Section III-2-1(1) of the Guidelines.
114 Article 299(v) of the COOFIN.
115 Article 66-31(3) of the Act and Article 305 of the COOFIN.
116 Article 66-39 of the Act; Article 318(iii)(a) of the COOFIN.

972. In particular, in assessing whether an exemption from the application of the rotation rules can be granted to a foreign credit rating agency, the Guidelines on this issue explain that the supervisory departments would take the following into consideration:

"From the perspective of ensuring the quality of the rating process and keeping collusive relationships with rating stakeholders in check, whether the credit rating committee functions effectively, and whether the rating process has been properly built, such as by ensuring restraint through the internal audit division. Also, whether the credit rating agency has taken appropriate measures for preventing entrenchment in the process for the appointment of person in charge of ratings."[117]

973. Following the approval, in such cases as where a problem is found in the execution of the alternative measures, the supervisory departments shall consider necessary actions, including the rescission of approval based on Article 306(8) of the COOFIN[118].

Box 36

Quality of credit ratings and analysis of information used in assigning credit ratings

974. CESR considers that, the objective of this set of EU requirements is met.

975. The Japanese framework requires credit rating agencies to adopt policies for the determination of their credit ratings that provide for a comprehensive analysis of all the relevant information collected.

976. CESR understands following additional clarification on this point from the staff of the JFSA that, irrespective of the lack of any specific provision to this effect, in order to ensure that the information used in determining a credit rating is of sufficient quality, the aforesaid measures should require to use information from reliable sources.

977. There is a requirement for credit rating agencies to implement measures to verify and update credit ratings in an appropriate manner and on an ongoing basis. These measures are expected to include also internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings.

978. Credit rating agencies are required to implement measures to provide rating stakeholders with credit ratings within a reasonable time in advance of publication so as to enable them to check if there are any factual errors. However, there is no explicit requirement for the rating stakeholder to be informed at least 12 hours before the publication, the length of this time is left to the credit rating agency to determine for itself.

979. Credit rating agencies are required to refrain from issuing a credit rating if they do not have sufficient quality information to base their ratings on. CESR understands following additional clarification on this point from the staff of the JFSA that, irrespective of the lack of any specific provision to this effect, in a such situation, credit rating agencies would in practice also have to withdraw their existing ratings.

980. Credit rating agencies are required to implement procedures for the rotation of their lead analysts or the rotation of at least one-third of the total members of the rating committee.

117 Section III-3-3(1) of the Guidelines.
118 Section III-3-3 of the Guidelines.

981. Overall the Japanese requirements in this area are comprehensive and similar to those of the EU requirements, and in some respects even more detailed than in the EU as a result of the way in which their framework sets out the obligations between the Act, the COOFIN and the Guidelines.

(4) Quality of methodologies and Changes to them

982. This set of EU requirements, as set out in paragraph **167** above, imposes obligations on a credit rating agency to:

a) Use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing;

b) Apply the changes in methodologies and models consistently to existing ratings; and

c) Immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distributions of the affected credit ratings.

a) Use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back testing

983. Article 8.3 of the EU Regulation requires a credit rating agency to use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back testing.

984. As indicated by the JFSA's staff answer to Q21c, in Japan, the requirements imposed in relation to the "rating determination policy" include that such policies shall be rigorous and systematic and that they need to contain a description of the explanation about the validity of the criteria. As a result, CESR understands following additional clarification on this point from the staff of the JFSA that irrespective of the lack of any specific requirement for the rating methodologies to be continuous and subject to validation based on historical experience including to back testing, this is required by the need for credit rating methodologies to be rigorous and, systematic.

985. Namely, Article 313(2)(i) of the COOFIN provides that:

"The Rating Determination Policy, etc. shall satisfy the following requirements:
(i) that it is rigorous and systematic."

986. Article 313(2)(iii) of the COOFIN provides that the "rating determination policy" needs to provide for the following matters, in accordance with the categories of objects of credit rating and detailed items thereof:

"(a) the criteria used for identifying the matters which serve as the assumptions for the assessment of the credit status, and the criteria used for the setting of grades indicating the results of the assessments of the credit status; and
(b) an outline of the method for the determination of Credit Ratings."

Box 37

Using rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience including back testing

987. CESR considers the objective of these EU requirements to be met, as the Japanese framework requires that credit rating agencies adopt a "rating determination policy" which is rigorous and systematic. Irrespective of the fact that there is not a specific requirement for the rating methodologies to be continuous and subject to validation based on historical experience including to back-testing, CESR understands following additional clarification on this point from the staff of the JFSA that that this aspect is covered by the requirement to have rigorous and systematic credit rating methodologies.

b) Apply changes to methodologies and models consistently to existing ratings

988. As indicated by the JFSA's staff answer to question Q21h, a credit rating agency is required to implement, as part of their operational control systems, measures to review the affected credit ratings in case of material changes in its "rating determination policy".

989. As described in paragraph **909** above, Article 306(1)(vi)(e) of the COOFIN provides that the operational control systems required to be established by a credit rating agency shall include:

"the measures to be implemented in cases of any material amendment to the Rating Determination Policy, etc., if any, so as to announce, without delay, the scope of Credit Ratings already determined in accordance with the former Rating Determination Policy, etc. but which require further consideration as to the necessity of being updated in accordance with the amended Rating Determination Policy, etc. and the period of time required for such updating, as well as to update the Credit Ratings within such period of time".

Box 38

Apply changes to methodologies and models consistently to existing ratings

990. CESR considers that the objectives of the EU requirements in this area are met, as credit rating agencies are required to implement, as part of their operational control systems, measures to update consistently the credit ratings that are affected by material amendments to their rating determination policy. The requirements in Japan are comprehensive and similar.

c) Immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distribution of the affected credit ratings

991. As indicated in paragraph **907** above, a credit rating agency is required to take measures to publish without delay the range of potentially impacted credit ratings as well as the period necessary for updating.

992. However, there is no requirement for this disclosure to be made by using the same means of communication as was used for the distributions of the affected credit ratings. A credit rating agency

needs to set up and disclose information on a policy on how it intends to communicate with market participants.

993. This requirement is set out in Article 306(1)(vi)(e) of the COOFIN which provides that the operational control systems the need to be established by a credit rating agency shall include:

"the measures to be implemented in cases of any material amendment to the Rating Determination Policy, etc., if any, so as to announce, without delay, the scope of Credit Ratings already determined in accordance with the former Rating Determination Policy, etc. but which require further consideration as to the necessity of being updated in accordance with the amended Rating Determination Policy, etc. and the period of time required for such updating, as well as to update the Credit Ratings within such period of time."

994. As discussed in paragraphs **910** and **911** above, the details of these measures are to be provided to the JFSA as part of the registration process and disclosed to the public through the explanatory documents prepared and published by a credit rating agency for each business year.

Box 39

Immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distribution of the affected credit ratings.

995. CESR considers the objective of the EU requirement to be met, as a credit rating agency is required to implement, as part of its operational control systems, measures to disclose, without delay, the scope of credit ratings already determined to be affected by material amendments to its "rating determination policy".

996. CESR notes that there is no explicit requirement for this disclosure to be made by using the same means of communication as was used for the distributions of the affected credit ratings.

(5) Competition

997. The EU requirements in this area are set out in paragraph **170** above. As set out in paragraph **171** above, for the purposes of assessing equivalence, CESR can accept that the third country legal and regulatory framework does not include these requirements, but as discussed below, the Japanese framework does include similar requirements.

a) Not to refuse to issue a credit rating of an entity or a financial instrument because a position of the entity or the financial instrument had been previously rated by another credit rating agency where a credit rating agency is using an existing credit rating prepared by another CRA with respect to the underlying assets or structured finance instruments

998. In Japan, where a credit rating agency is using an existing credit rating prepared by another credit rating agency with respect to underlying assets or asset securitisation products, it is prohibited from refusing to issue a credit rating of an asset securitisation product because this product or the underlying assets had been previously rated by another credit rating agency.

999. The prohibition is included in the list of "prohibited acts" under Article 312(iii) of the COOFIN:

"The acts specified by Cabinet Office Ordinance, as referred to in Article 66-35, item (iii) of the Act, shall be as follows:
(iii) in cases where the object of a Credit Rating is the assessment of the credit status of Asset Securitization Products, the act of refusing to determine a Credit Rating for the assessment of credit status of such Asset Securitization Products, merely on the grounds that any other Credit Rating Agency had already determined a Credit Rating for the assessment of the credit status of such Asset Securitization Products or the relevant Underlying Assets."

1000. CESR understands following further clarification of this point from the staff of the JFSA that irrespective of the lack of any specific provision to this effect**,** this provision does cover the prohibition to refuse to issue a credit rating of an entity because a position of the entity had been previously rated by another credit rating agency.

b) Record all instances where in its credit rating process it departs from existing credit ratings prepared by another credit rating agency with respect to the underlying assets or structured finance instruments providing a justification for the differing assessment

1001. A credit rating agency is not specifically required to always provide a justification for the different assessment to that of another credit rating agency, but only explicitly required to do so in cases where a quantitative model has been used to determine the rating. However a credit rating agency is always required to record information in books and documents as part of its record keeping obligations that could be used for a comparison to existing credit ratings prepared by another credit rating agency.

1002. The information to be recorded in relation to the determination of a credit rating includes, among other things, the basis of the decision-making.

1003. This is required by Article 315(1)(i), letters (d), (f) and (g), of the COOFIN which states that the books and documents to be prepared by a credit rating agency pursuant to the provision of Article 66-37 of the Act shall include, among other things, the following information:

"(d) in cases where the final decision of a Credit Rating Agent in determining the Credit Rating is to be adopted by a resolution of the counsel, the names of the counsel members, the materials submitted to the counsel, the basis of the decision making and any other records (in cases where the final decision is adopted by means other than a resolution of the counsel, to that effect and the grounds therefore);
(f) in cases where the Credit Assessment was implemented based primarily on quantitative analysis, and where there exists a significant difference between the results of the Credit Assessment based on the quantitative analysis and the Credit Rating actually determined, the major grounds which provided the basis for such difference;
(g) the materials which served as the basis for the determination of the Credit Rating (including records on the progress of negotiations with the Rating Stakeholder)".

1004. The records must be kept for 5 years after their preparation[119].

1005. In examining whether a credit rating agency has kept books and records in compliance with the aforesaid Article 315 of the COOFIN , the Guidelines on this issue explain that supervisory departments need to consider, among other things, the following:

a) whether the credit rating agency has stipulated in its internal rules specific methods for preparing and storing the books and documents listed in Article 315 of the COOFIN ;

119 Article 315(2) of the COOFIN.

b) whether the conditions for the storage of information through electronic media set out in the Guidelines are respected.[120]

Box 40

Competition

1006. CESR considers that, despite the differences outlined below, the objectives of the EU requirements in this area are met by the Japanese requirements.

1007. Where a credit rating agency is using an existing credit rating prepared by another credit rating agency with respect to underlying assets or asset securitisation products, it is prohibited from refusing to issue a credit rating of an asset securitisation product because this product or the underlying assets had been previously rated by another credit rating agency. CESR understands following further clarification of this provision from the staff of the JFSA, that irrespective of the lack of any specific provision to this effect, this provision does cover the prohibition to refuse to issue a credit rating of an entity because a position of the entity had been previously rated by another credit rating agency.

1008. Although a credit rating agency is not specifically required to always provide a justification for the different assessment to that of another credit rating agency, but only explicitly required to do so in cases where a quantitative model has been used to determine the rating, a credit rating agency is always required to record information in books and documents that could be used for a comparison to existing credit ratings prepared by another credit rating agency.

1009. CESR also considers that overall the Japanese provisions in this area are comprehensive, and in some cases similar to the EU requirements.

Box 41

QUALITY OF METHODOLOGIES AND QUALITY OF RATINGS

1010. CESR considers that the Japanese legal and supervisory framework for credit rating agencies meets all the objectives of EU requirements in respect of the quality of methodologies and quality of ratings, for the reasons explained above and set out below for ease of reference.

(1) Reviewing credit ratings, methodologies, models, assumptions and information used in issuing ratings

1011. CESR understands following additional clarification on this point from the staff of the JFSA that there is a requirement for a credit rating agency to appoint a specific review function, and that although there is not a specific requirement for the review function to be independent from the business lines responsible for the credit rating activities, this function covers a periodic review of methodologies, models and key rating assumptions from an independent standpoint. Namely, a credit rating agency is required to adopt measures for the performance of the credit rating business in accordance with its

120 Section III-3-4 of the Guidelines.

rating policy as well as measures to properly verify the appropriateness and effectiveness of its rating determination policy to ensure that a fair and unbiased stance is maintained in the performance of the credit rating activities.

1012. In addition, a credit rating agency is required to appoint a person responsible for supervising credit rating analysts in the process pertaining to the determination of credit ratings.

1013. CESR understands following further clarification from the staff of the JFSA on this issue, that irrespective of the lack of any specific provision to this effect, for these policies and procedures to be considered as properly established, there is a reasonable expectation that a credit rating agency will need to provide for the monitoring of the methodologies on an on-going basis and at least annually.

1014. A credit rating agency is required to implement measures that allow for an appropriate monitoring of credit ratings on an on-going basis.

1015. A credit rating agency is required: (i) to adopt measures to publish without delay the range of credit ratings potentially impacted by material amendments to its rating determination policy as well as the period necessary for updating, and (ii) to conduct the necessary updates in the stated period.

1016. The Supervisory Committee, composed for one-third or more by independent members, is responsible for ensuring that the above-mentioned measures are implemented.

(2) Knowledge and experience of employees directly involved in credit rating activities

1017. CESR considers that the Japanese requirements are very comprehensive in this area and ensure that those directly involved in credit rating activities have sufficient knowledge and experience.

(3) Quality of credit ratings and analysis of information used in assigning credit ratings

1018. The Japanese framework requires credit rating agencies to adopt policies for the determination of their credit ratings that provide for a comprehensive analysis of all the relevant information collected.

1019. CESR understands following additional clarification on this point from the staff of the JFSA that, irrespective of the lack of any specific provision to this effect, in order to ensure that the information used in determining a credit rating is of sufficient quality, the aforesaid measures should require to use information from reliable sources.

1020. There is a requirement for credit rating agencies to implement measures to verify and update credit ratings in an appropriate manner and on an ongoing basis. These measures are expected to include also internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings.

1021. Credit rating agencies are required to implement measures to provide rating stakeholders with credit ratings within a reasonable time in advance of publication so as to enable them to check if there are any factual errors. However, there is no explicit re-

quirement for the rating stakeholder to be informed at least 12 hours before the publication, the length of this time is left to the credit rating agency to determine for itself.

1022. Credit rating agencies are required to refrain from issuing a credit rating if they do not have sufficient quality information to base their ratings on. CESR understands following additional clarification on this point from the staff of the JFSA that irrespective of the lack of any specific provision to this effect, in such situation, credit rating agencies would be required to withdraw their existing ratings.

1023. Credit rating agencies are required to implement procedures for the rotation of their lead analysts or the rotation of at least one-third of the total members of the rating committee.

1024. Overall the Japanese requirements in this area are comprehensive and similar to those of the EU requirements, and in some respects even more detailed than in the EU as a result of the way in which their framework sets out the obligations between the Act, the COOFIN and the Guidelines.

(4) Quality of methodologies and changes to them

a) Using rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience including back testing

1025. CESR considers the objective of these EU requirements to be met, as the Japanese framework requires that credit rating agencies adopt a "rating determination policy" which is rigorous and systematic. Irrespective of the fact that there is no specific requirement for the rating methodologies to be continuous and subject to validation based on historical experience including to back-testing, CESR understands following additional clarification on this point from the staff of the JFSA that this aspect is covered by the requirement to have rigorous and systematic credit rating methodologies.

b) Apply changes to methodologies and models consistently to existing ratings

1026. Credit rating agencies are required to implement, as part of their operational control systems, measures to update consistently the credit ratings that are affected by material amendments to their rating determination policy. The requirements in Japan are comprehensive and similar.

c) Immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distribution of the affected credit ratings.

1027. A credit rating agency is required to implement, as part of its operational control systems, measures to disclose, without delay, the scope of credit ratings already determined to be affected by material amendments to its "rating determination policy".

1028. CESR notes that there is no explicit requirement for this disclosure to be made by using the same means of communication as was used for the distributions of the affected credit ratings.

(5) Competition

1029. **CESR considers that, despite the differences outlined below, the objectives of the EU requirements in this area are met by the Japanese requirements.**

1030. **Where a credit rating agency is using an existing credit rating prepared by another credit rating agency with respect to underlying assets or asset securitisation products, it is prohibited from refusing to issue a credit rating of an asset securitisation product because this product or the underlying assets had been previously rated by another credit rating agency. CESR understands following further clarification of this provision from the staff of the JFSA that irrespective of the lack of any specific provision to this effect, this provision covers the prohibition to refuse to issue a credit rating of an entity because a position of the entity had been previously rated by another credit rating agency.**

1031. **Although a credit rating agency is not specifically required to always provide a justification for the different assessment to that of another credit rating agency, but only explicitly required to do so in cases where a quantitative model has been used to determine the rating, a credit rating agency is always required to record information in books and documents that could be used for a comparison to existing credit ratings prepared by another credit rating agency.**

1032. **CESR also considers that overall the Japanese provisions in this area are comprehensive, and in some cases similar to the EU requirements.**

F. Disclosure

1033. Within this Section, the EU Commission required CESR to assess at least the following requirements:

Extract from the mandate

- A CRA discloses to what extent it has examined the quality of information used in the According to the EU mandate, CESR is required to assess at least the following issues regarding the presentation of credit ratings and the disclosure about the credit rating agency and its activities:
- rating process and whether it is satisfied with the quality of information it bases its rating on. It will not be allowed to rate financial instruments if it does not have sufficient quality information to base ratings on.
- A CRA discloses the models, methodologies and key assumptions on which it bases its ratings.
- A CRA differentiates the ratings of structured products by adding a specific symbol.
- A CRA has a clear and fair policy in relation to unsolicited ratings, which shall be differentiated as such.
- A CRA collects and provides on a regular basis historical performance data (default and transition studies), in accordance with commonly agreed standards.
- A CRA ensures on an on-going basis general disclosure of key information relating to its activity (i.e. on managing conflicts of interest, ancillary services provided, compensation arrangements for its staff, policy on the publication of credit ratings, etc.)
- A CRA makes periodical disclosures (i.e. data on the historical default rates, the 20 largest clients by revenue)
- A CRA makes public an annual transparency report with information on the ownership of the agency, staff allocation, description of the quality control system, outcome of the internal review of independence compliance, financial information regarding the revenue streams, etc.

1034. As discussed in paragraphs **173** to **198** above, the EU Regulation sets out core prescriptive disclosure requirements on credit rating agencies.

1035. For the purposes of this paper, CESR has divided these requirements into the following two categories:

(i) presentation and disclosure of credit ratings, and
(ii) general and periodic disclosure about the credit rating agency.

1036. The requirements under point *(i)* have in their turn been divided between:

a. general provisions on the presentation and disclosure of any credit ratings, and
b. additional requirements in respect of the presentation and disclosure of credit ratings for structured finance products.

1037. The requirements under point *(ii)* have been divided between :

a. general additional disclosure requirements, and
b. periodic additional disclosure requirements.

1038. The same order will be followed in the present section in assessing the Japanese regulatory framework.

Presentation and disclosure of ratings

A. General provisions on the presentation and disclosure of any credit ratings

1039. As outlined in paragraph **176** above, the EU requirements on the presentation and disclosure of credit ratings aim at ensuring a timely and non-selective disclosure of credit ratings and the provision of adequate information to investors and other users of credit ratings in order to enable them to conduct their own due diligence regarding whether to rely on a credit rating.

1040. In assessing equivalence, as discussed in paragraph **179** above, CESR expects that, overall, the objectives of each individual EU requirement described in paragraphs **177** to **178** above be met through provisions embedded in the third country legal and regulatory framework, together with proper and effective supervision, although it considers that the differences highlighted in paragraph **180** above may be accepted.

Japanese approach to disclosure and presentation of credit ratings

1041. In Japan, a credit rating agency is required to establish, publish and adhere to a "rating determination policy" and to a "rating provision policy" setting out, respectively, the policies and methods to determine credit ratings, and the methods and policies to provide or make available to the public its credit ratings.[121]

1042. This is required by Article 66-36 of the Act which provides that:

"(1) A Credit Rating Agency shall, pursuant to the provisions of Cabinet Office Ordinance, ***establish the policies and methods for determining and also either providing to someone or making available to the public the Credit Ratings*** *(such policies shall collectively referred to as the "Rating Policy, etc." in the following paragraph)* ***and publish the said Rating Policy, etc****. The same shall apply when the Credit Rating Agency has changed the Rating Policy, etc.*
(2) A Credit Rating Agency ***shall conduct its Credit Rating Business in accordance with its Rating Policy****, etc."*

1043. The "rating provision policy" needs to satisfy minimum requirements concerning disclosure of credit ratings set out in Article 313(3) of the COOFIN.

1044. The "rating provision policy" needs to be attached to the written application as part of the process of registration[122], and needs to be published in a manner which allows easy inspection by investors and credit rating users at any time, by means of the use of the internet or any other means[123].

1045. In cases where a credit rating agency intends to effect any material change to its "rating provision policy", it needs to, in advance of doing so, announce the fact that the change will be effected and provide an outline of such change. However, if any unavoidable ground exists, such unavoidable ground, the fact of the change and an outline thereof may be announced without delay after the change[124].

121 Article 66-36 of the Act and Article 313 of the COOFIN.
122 Article 66-28(2)(ii) of the Act and Article 299(xxxvii) of the COOFIN.
123 Article 314(1) of the COOFIN.
124 Article 314(3) of the COOFIN.

1046. The Guidelines set out the approach that the supervisory departments intend to adopt to monitor information disclosure when conducting their ongoing supervision of credit rating agencies.

1047. Section III-2-3 (1)(i)(ii) of the Guidelines provides that:

"Supervisory departments shall examine the appropriateness of the formulation and disclosure of rating policy, etc. by taking the following points into consideration.

i. In making information public, whether the credit rating agency, having first categorized between rating determination policy, etc., and rating provision policy, etc. (policies and methods relating to the acts of providing credit ratings or making them available for inspection; the same shall apply hereinafter), makes descriptions that are appropriate and easy to understand for investors and other credit-rating users.

ii. When making rating policy, etc. public by posting them on its internet website, whether the credit rating agency displays them in an area on the screen which is easily recognized."

1048. In limited cases, two or more credit rating agencies that jointly perform credit rating activities in the course of trade may jointly formulate and announce the rating policy.[125]

1049. In this respect, Section III-2-3 (1))(iii) of the Guidelines provides that:

"Supervisory departments shall examine the appropriateness of the formulation and disclosure of rating policy, etc. by taking the following points into consideration.

iii. Under Article 314(2) of the FIB Cabinet Office Ordinance, credit rating agencies that conduct business as a group are, under certain conditions, permitted to jointly establish and make public their rating policy, etc.. In such cases, whether the credit rating agency displays, in an easy to understand manner, the names of the credit rating agencies which have jointly formulated and publicized the rating policy, etc."

1050. In addition to the above, a credit rating agency needs to publish on an on-going basis on its website and make available for public inspection explanatory documents that need to be updated annually:

"A Credit Rating Agency shall, for each business year, prepare explanatory documents containing the matters specified by Cabinet Office Ordinance as the matters concerning status of business, and keep the said explanatory documents at all of its business offices or offices and make them available for public inspection, as well as publicizing them via the Internet or by any other method pursuant to the provisions of Cabinet Office Ordinance, for one year from the day on which the period specified by Cabinet Order has elapsed after the end of each business year."[126]

1051. The explanatory documents need to include, among other things, an outline of the "rating policy" (i.e. "rating determination policy" and "rating provision policy").[127].

1052. According to Section III-2-3 (2)(i) of the Guidelines, the supervisory departments shall conduct examinations by taking into consideration:

"Whether the explanatory documents are ready to be inspected at anytime at the request of a customer. Also, whether the credit rating agency appropriately publicizes its explanatory documents through methods such as posting them on its website."

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125 Article 314(2) of the COOFIN. Namely, the application of this provision is limited to the cases where said two or more credit rating agencies fall under the category of "Associated Juridical Persons", and where they share the same Officers and Representative Person in Japan or a person as set forth in Article 297 of the COOFIN (Person Equivalent to Representative Person in Japan of Foreign Juridical Person).

126 Article 66-39 of the Act and Articles 318 and 319(1) of the COOFIN.

127 Article 318(iv) of the COOFIN.

1053. Credit rating agencies that are registered with the JFSA and conduct business as a group are, under certain conditions, permitted to jointly draw up and make public their explanatory documents[128]. In such cases, the supervisory departments shall conduct examinations by taking into consideration whether an outline of the rating policy has been described for each credit rating agency[129].

(i) Disclosure of any credit rating, as well as any decisions to discontinue a credit rating, on a non-selective basis and in a timely manner

1054. As can be seen by the positive answer given to Q22a and Q22b, in Japan, credit ratings and decisions to discontinue credit ratings are to be disclosed without delay.

1055. The "rating provision policy" - to be established, published and adhered to by a credit rating agency pursuant to Article 66-36(1) of the Act - shall provide among other things that:

- "acts to provide or to make available to the public the determined Credit Ratings are to be implemented without delay after the determination of such Credit Rating";
- "the acts to provide or to make available to the public the determined Credit Ratings should be implemented for the general public"[130].

1056. In addition, in cases where the credit rating agency does not intend to update the determined credit rating, such fact and the grounds thereof shall be announced by use of Internet or by any other means as set out in Article 313 (3) (h) of the COOFIN [131].

1057. The "rating provision policy" needs to provide for:

"information on the withdrawal of the determined Credit Rating shall be provided without delay"[132].

1058. According to Article 313 (3)(iii)(h) of the COOFIN there is a requirement to disclose the fact that a credit rating agency does not intend to update a credit rating (intends to discontinue a credit rating) and the reason for this decision.

Box 42

Disclosure of any credit rating, as well as any decisions to discontinue a credit rating, on a non-selective basis and in a timely manner

1059. CESR considers that the objective of the relevant EU requirements is met, as credit rating agencies are required: (i) to provide or make available to the public the determined credit ratings without delay; (ii) to announce the intention not to update a determine credit rating and the grounds thereof, and (iii) to provide information on decisions to discontinue credit ratings and the relevant reasons without delay.

Ban to use the name of the competent authority in a way to indicate endorsement or approval of credit ratings

128 Article 319(2) of the COOFIN.
129 Section III-2-3(2)(iii) of the Guidelines.
130 Article 313(3)(i)(ii) of the COOFIN.
131 Article 313(3)(h) of the COOFIN.
132 Article 313(3)(iv) of the COOFIN.

1060. As shown by the JFSA's staff answer to Q22f, the Japanese legal and regulatory framework prohibits credit rating agencies from using the name of any competent authority in such a way that would indicate or suggest endorsement or approval by that authority of the credit ratings or any credit rating activities of the credit rating agency.

1061. This is set out in Article 313(3)(v) of the COOFIN which states that the "rating provision policy" to be established, published and adhered to by a credit rating agency needs to provide that the credit rating agency has:

"not to make any representation as to the appropriateness of the results of the Credit Assessment, which may lead to a misperception that such appropriateness has been guaranteed by the Commissioner of the Financial Services Agency or any other administrative organ".

Box 43

Ban to use the name of the competent authority in a way to indicate endorsement or approval of credit ratings

1062. CESR considers that the objective of the relevant EU requirement is met, as the Japanese legal framework explicitly prohibits credit rating agencies from making any representation regarding the appropriateness of the results of the credit assessment, which may lead to a misperception that such appropriateness has been guaranteed by the JFSA.

Unsolicited credit ratings

1063. The EU Regulation provides that credit rating agencies need to have a clear and fair policy in relation to the determination of unsolicited credit ratings. In addition, the EU Regulation prescribes that unsolicited credit ratings must be differentiated as such. When issuing an unsolicited credit rating, a credit rating agency is required to prominently state in the credit rating whether or not the rated entity or related third party participated in the credit rating process and whether the credit rating agency had access to the accounts and other relevant internal documents of the rated entity or its related third party.

1064. CESR considers that the above information is of relevance for investors and other credit rating users to make their own assessment regarding the quality of credit ratings. In fact, while for solicited credit ratings it is likely that a rated entity participated in the determination of the credit rating and the credit rating agency had access to the books and records of the rated entity, in the case of unsolicited credit ratings this may depend on each case. It is therefore relevant for investors and other credit rating users to know whether, for that particular credit rating, the rated entity participated in the rating process and the credit rating agency had access to the books and records of the rated entity.

1065. CESR recognises that most of the ratings issued under the subscription-based model are unsolicited. However, CESR points out that no assumption can be made that the quality and quantity of information available for the determination of credit ratings is wider in the case of credit ratings initiated upon request of the rated entity than in the case of unsolicited credit ratings. In any case, the users of credit ratings should not rely blindly on credit ratings but should take the utmost care to perform their own analysis and conduct appropriate due diligence at all times regarding their reliance on such credit ratings.

- *Differentiated policy in relation to unsolicited ratings*

1066. As can be seen by the JFSA's staff positive answer to Q22d, in Japan, a credit rating agency is required to have a differentiated policy in relation to unsolicited credit ratings.

1067. This requirement is set out in Article 66-36 of the Act, according to which a credit rating agency is required to establish, publish and adhere to a "rating determination policy", setting out the methods and policies concerning the determination of credit ratings.

1068. The "rating determination policy" needs to satisfy minimum requirements set out by the COOFIN and must include specific policies and methods for determining unsolicited credit ratings.

1069. Article 313(2)(v) of the COOFIN states that:

"The Rating Determination Policy, etc. shall satisfy the following requirements:
(v) that it provides for the policies and methods for determining a Credit Rating, in cases of determining a Credit Rating without a solicitation from any Rating Stakeholder".

1070. In addition, a credit rating agency is required to provide information regarding its policies and methods for determining unsolicited credit ratings in the application process for registration[133].

1071. The same information is to be published as part of the "rating determination policy" in accordance to the aforesaid Article 66-36 of the Act.

1072. According to Section III-2-3(1)(i)(ii) of the Guidelines, the supervisory departments need to monitor that the description of the "rating determination policy" disclosed by the credit rating agency is appropriate and easy to understand for investors and other credit-rating users, and it is displayed in an area of the credit rating agency's website that is easily recognised.

1073. In addition, an outline of the "rating policy", including the "rating determination policy", needs to be included in the explanatory documents that must be prepared and published by the credit rating agency for each business year as set out in Article 66-39 of the Act[134].

- *Disclosure concerning the participation of the rated entity or related third party in the credit rating process and the access by the credit rating agency to the internal documents of the rated entity or related third party*

1074. A credit rating agency is required to record, and preserve for at least 5 years, information regarding whether the credit rating was determined in response to solicitation from any rating stakeholder, and the materials, which served as the basis for the determination of the credit rating (including records on the progress of negotiations with the rating stakeholder)[135].

1075. In addition, as can be seen by the JFSA staff answer to Q22e, when issuing an unsolicited credit rating, a credit rating agency is required to publicly announce the fact that the credit rating is issued without solicitation by the rated entity. A credit rating agency needs to also announce, by Internet or other means, information regarding whether it had access to material internal documents of the rated entity in the credit rating process.

1076. This is required by Article 313(3)(iii)(g) of the COOFIN that provides that the "rating provision policy" shall meet, among other things, the following requirement:

133 Article 66-28(2)(ii) of the Act and Article 299(xxxvi)(c) of the COOFIN.
134 Article 66-39 of the Act; Article 318(iv) and Article 319(1) of the COOFIN.
135 Article 315(1)(i) letters (g) and (h) of the COOFIN.

"that it provides that, in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):
(g) in cases where the Credit Rating was determined without any solicitation from the Rating Stakeholder, such fact, and information as to whether any undisclosed information (limited to the information which is found to have material influence on the Credit Rating) had been obtained from the Rating Stakeholder in the process of determining the Credit Rating".

Box 44

Unsolicited credit ratings

1077. CESR considers that the objective of the EU requirement to enable investors and other credit rating users to identify unsolicited credit ratings is met.

1078. The Japanese framework has specific provisions that require a credit rating agency to establish differentiated policies and methods to determine credit ratings in case of unsolicited credit ratings, which shall be published as part of the "rating determination policy".

1079. In addition, when unsolicited credit ratings are provided or made available to the public, the credit rating agency is required to announce by Internet or any other means the fact that the rating is unsolicited as well as information regarding whether the credit rating agency had access to material undisclosed information provided by the rated entity in the credit rating process.

Explanation of the key elements underlying the credit rating in the press releases or reports

1080. As indicated in paragraph **180** above, CESR considers that the third country legal and regulatory framework needs to ensure that the public receives information about the key elements of the credit ratings, but can accept that the third country rules do not prescribe that these elements are to be provided in the press releases or reports.

1081. In Japan, as set out in Articles 313(3)(iii)(d) and 313(3)(iii)(j) of the COOFIN, the "rating provision policy" needs to require that, when credit ratings are provided or made available to the public, a credit rating agency must announce, by Internet or other means, among other things:

- the objects of the credit ratings;
- an outline of the criteria used for identifying the matters which serve as the assumptions for the assessment of the credit status, and the criteria used for the setting of grades indicating the results of the assessments of the credit status;
- an outline of the method for the determination of the credit rating (in cases where two or more methods for determining a credit rating have been adopted, including such fact and the grounds);
- an outline of the principal information used to determine credit ratings, an outline of the provider of such information and the measures implemented for the purposes of the quality assurance of such information.

1082. In addition, as can be seen by the JFSA's staff answer to Q28, the "rating provision policy" needs also to provide for the credit rating agency to announce, by Internet or other means, an explanation regarding the assumptions, significance and limitations of the determined credit ratings.

1083. This is required by Article 313(3)(iii)(i) of the COOFIN which provides that the "rating provision policy" needs to meet, among other things, the following requirement:

"that it provides that, in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):
(i) an explanation on the assumptions, significance and limitations of the determined Credit Rating, in accordance with the category of the object of such Credit Rating (including an explanation on the characteristics of the fluctuation of Credit Ratings; and also including an explanation on the limitations of the Credit Rating, in cases where the object of the Credit Rating is the assessment of the credit status of the financial instruments with limited information on the transition of the credit status)".

Box 44

Explanation of the key elements underlying the credit rating in the press releases or reports

1084. CESR considers that the objective of the EU requirement to enable investors and other credit rating users to be informed about the key elements underlying each credit rating is met.

1085. When credit ratings are provided or made available to the public, there are specific requirements on credit rating agencies to announce by use of Internet or by any other means: (i) an explanation on the assumptions, significance and limitations of the determined credit rating, (ii) information on the objects of the credit rating, (iii) an outline of the criteria and methods used to determine the credit rating, and (iv) an outline of the principal information used to determine credit ratings, the provider of such information and the measures implemented for the purposes of the quality assurance of such information.

Historical performance data

1086. According to the EU Regulation, a credit rating agency is required to disclose information on its historical performance data, including the ratings transition frequency and information about credit ratings issued in the past and on their changes.

1087. The disclosure requirement is intended to allow interested parties to understand the historical performance of each rating category, and if, and how, rating categories have changed.

1088. As can be seen by the JFSA staff answer to Q29, the Japanese legal and regulatory framework requires a credit rating agency to disclose in its explanatory documents:

- statistical information or any other information on the transition of the credit status of the financial instruments or juridical persons (limited to cases where the object of the credit rating is the assessment of such credit status);

- information on the historical data of the determined credit ratings (limited to information at the time when one year or more has passed from the day when the credit rating was determined).[136]

136 Article 66-39 of the Act and Articles 318(ii)(b)(3) and 318(ii)(b)(4) of the COOFIN.

1089. The explanatory documents need to be prepared and published for each business financial year by such means as the use of Internet so as to allow for an easy inspection by investors and credit rating users at any time.[137]

Box 46

Historical performance data

1090. CESR considers that the objective of this EU requirement – namely, to enable investors and other credit rating users to be informed about historical performance data - is met.

1091. A credit rating agency is required to include information on the historical data of the determined credit ratings and statistics on the transition of the credit status of the financial instrument or judicial person in the explanatory documents that need to be prepared and published for each business year, on the Internet.

Details of the lead rating analyst and the person primarily responsible for approving the rating

1092. According to the EU Regulation, credit rating agencies are required to indicate in their credit ratings the name of the lead rating analysts as well as the name and the position of the person primarily responsible for approving the rating.

1093. The Japanese legal and regulatory framework does require a credit rating agency to record and to publicly disclose, on a rating-by-rating basis, information on the names of the lead rating analysts and of the person primarily responsible for approving the ratings.

1094. This requirement is set out in Article 66-37 of the Act and Article 315(1)(i)(c)(d) and Article 315(2) of the COOFIN which require a credit rating agency to prepare and preserve for at least five years certain books and documents on business operations, that include:

"(c) the name of the Rating Analyst who participated in the process of determining the Credit Rating; the name of the person, as a representative of the Credit Rating Agency, was responsible for determining the Credit Rating;

(d) in cases where the final decision as a Credit Rating Agency in determining the Credit Rating is to be adopted by a resolution of the council, the names of the council members, the materials submitted to the council, the basis of the decision-making and any other records (in cases where the final decision is adopted by means other than a resolution of the council, to that effect and the grounds therefore)".[138]

1095. In addition, Article 313(3)(iii)(c) of the COOFIN provides that the "rating provision policy" shall meet, among other things, the following requirement:

"that it provides that, in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):

137 Article 319(1) of the COOFIN.

138 In addition Article 315(1)(i)(e) of the COOFIN requires a credit rating agency to record the following information: *"in cases where any Associated Juridical Person participated in the process for determining the Credit Rating the name and address of this Associated Juridical Person"*

(c) the name of the Lead Rating Analyst" who *"participated in the process of determining the Credit Rating, and the name of the person who, as a representative of the Credit Rating Agency, is responsible for determining Credit Ratings".*

1096. Credit rating agencies are not required to explicitly record the job titles of the lead analysts or person approving the ratings or to publicly disclose information on the job titles of these individuals – but this information is available upon request to the JFSA as clearly the credit agency will know the job titles of its employees without having the need for a specific requirement to record this.

Box 47

Details of the lead rating analyst and the person primarily responsible for approving the rating

1097. CESR considers that the objective of the relevant EU requirement is met, as a credit rating agency is required, when the determined credit ratings are provided or made available to the public, to announce by use of the Internet or by any other means information on the name of the lead rating analyst who participated in the process for determining the credit rating and of the person who, as a representative of the credit rating agency, is responsible for determining the credit rating.

1098. CESR notes that there is a difference with the EU requirement in that in Japan there is no explicit requirement for the job titles to be recorded or publicly disclosed but that they will upon request be provided to the JFSA as clearly the credit agency will know the job titles of their employees without having the need for a specific requirement to record this, but CESR does not consider this difference to impact the overall conclusion that the objective of this requirement is met.

Indication of all substantially material sources

1099. The EU Regulation requires credit rating agencies to indicate in the credit ratings all substantive material sources used to prepare the rating, with an indication as to whether the credit rating has been disclosed to that rated entity or its related third party and amended following that disclosure.

1100. In Japan, information on the principal information used in determining a credit rating is to be disclosed on a rating-by-rating basis.

1101. The Japanese provision requires that the "rating provision policy" that needs to be established, published and adhered to by a credit rating agency pursuant to Article 66-36(1) of the Act has to provide that:

" in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):

(j) the following matters concerning the principal information used in the course of determining the Credit Rating:
1. an outline of said information;
2. an outline of the measures implemented for the purpose of the quality assurance of said information; and
3. the provider of said information"[139].

139 Article 313(3)(iii)(j) of COOFIN.

1102. CESR understands following additional clarification on this point from the staff of the JFSA that irrespective of the lack of any specific provision to this effect, the above mentioned disclosure regarding the measures to be implemented for the purposes of the quality assurance of the principal information used in the credit rating process is expected to provide information regarding whether the credit rating has been disclosed to the rated entity or its related third party in accordance with the requirement set out in Article 313(2)(iv) of the COOFIN discussed below.

1103. However there is no requirement to indicate whether the credit rating was amended or not following disclosure to the rated entity.

1104. Article 313(2)(iv) of the COOFIN, in fact, provides that the "rating determination policy" shall satisfy, among other things, the following requirement:

"that it provides for the policies and methods which enable a Rating Stakeholder, in advance of providing or making available to the public the determined Credit Rating, to verify whether there was any factual misperception as to the principal information used by the Credit Rating Agency in determining the Credit Rating (including policies and methods for securing a reasonable length of time which allows the Rating Stakeholder to express its opinions)".

1105. In this respect, Section III-2-3 (1)(v) of the Guidelines provides that:

"Supervisory departments shall examine the appropriateness of the formulation and disclosure of rating policy, etc. by taking the following points into consideration:
(v) whether the credit rating agency has clearly and appropriately stated, not only the policies and processes for ensuring a reasonable amount of time needed for the said rating stakeholder to express his/her opinions, but also the handling of instances where time is needed to check whether there are any factual errors".

1106. Records on the progress of important negotiations between officers or employees of the credit rating agency and the rated entity concerning the credit rating activities are to be prepared and kept for at least 5 years.[140]

Box 48

Indication of all substantially material sources

1107. CESR considers that the objective of the EU requirement to enable investors and other credit rating users to be informed about all material sources used to determine an individual credit rating is met. When a credit rating is published or made available to the public, a credit rating agency is required to disclose, by use of Internet or by another means, an outline of the principal information used in the course of determining that credit rating.

1108. CESR considers that the Japanese legal and regulatory framework achieves the objective of the EU requirement to allow investors and other credit rating users to be informed as to whether a credit rating has been disclosed to the rated entity or its related third party. For each determined credit rating, a credit rating agency is required to publicly disclose, via Internet or by any other means, an outline of the measures implemented for the purposes of the quality assurance of the principal information used in determining that rating. These measures shall include procedures to allow the rated entity to check any factual errors before a determined credit rating is provided or made available to the public.

140 Article 66-37 of the Act; Article 315(1)(viii) and Article 315(2) of the COOFIN.

1109. CESR notes that there is no requirement to indicate whether or not the credit rating was amended following disclosure to the rated entity, this has no impact on CESR's conclusion that the objectives of this EU provision are met.

Indication of the principal methodology or methodology version used

1110. According to the EU Regulation, credit rating agencies are required to clearly indicate the principal methodology or version of methodology that was used in determining the credit rating, with a reference to its comprehensive description. Where the credit rating is based on more than one methodology, or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, the credit rating agency needs to explain this fact in the credit rating and indicate how the different methodologies or these other aspects are taken into account in the credit rating.

1111. The information on the specific methodology used in determining a specific credit rating is necessary for investors and other credit rating users to make their own assessment on the reliance on such credit rating.

1112. The Japanese legal and regulatory framework does require disclosure of the above mentioned information on a rating-by-rating basis. This is in addition to the general requirement to disclose upfront, in the "rating determination policy", the methodologies used in the credit rating activities.

1113. This requirement is set out in Article 313(2)(iii)(b) of the COOFIN which provides that the "rating determination policy" to be established, published and adhered to by a credit rating agency shall include, for each category of credit ratings:

"an outline of the method for the determination of Credit Ratings".

1114. Article 313(3)(iii)(d) of the COOFIN states that the "rating provision policy" shall provide that, in cases where the determined credit ratings are to be provided or made available to the public, the credit rating agency shall announce, by use of Internet or by another means, an outline of the method for the determination of the credit rating.

1115. As explained in Section III-2-3 (1)(i) of the Guidelines, the description of the credit rating determination policy needs to be appropriate and easy to understand for investors and other credit rating users.

1116. In cases where two or more methods for determining a credit rating have been adopted, the information disclosed shall include such fact and the grounds therefore.

Box 49

Indication of the principal methodology or methodology version used

1117. CESR considers that the objective of this EU requirement is met, as, in addition to the general requirement for a credit rating agency to publish upfront its "rating determination policy", there is a requirement to disclose, via Internet or by any other means, the methodology (ies) used to determine a credit rating, on a rating-by-rating basis.

Meaning of each rating category, the definition of default or recovery and any appropriate risk warning

1118. The EU Regulation requires credit rating agencies to explain the meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions, such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings as well as best-case scenario credit ratings.

1119. In Japan, the "rating determination policy" to be established, published and adhered to by a credit rating agency pursuant to Article 66-36(1) of the Act shall include, for each category of credit ratings:

"the criteria used for identifying the matters which serve as the assumptions for the assessment of the credit status, and the criteria used for the setting of grades indicating the results of the assessments of the credit status".[141]

1120. In addition, the "rating provision policy" shall provide that, in cases where a determined credit rating is to be provided or made available to the public, the credit rating agency shall announce, by the use of Internet or by another means, an outline of these criteria as well as the objects, assumptions, significance and limitations of that credit rating.[142]

1121. CESR understands following additional clarification on this point from the staff of the JFSA that this disclosure shall cover the meaning of each rating category, the definition of default or recovery and in terms of any appropriate risk warning requirement CESR understands that irrespective of the fact that there is no specific provision to disclose any appropriate risk warning**,** this would in practice result in an explanation of the characteristics of the fluctuation of the credit rating and its limitations. For structured finance products this would include an analysis of loss, cash flow and sensitivity.

Box 50

Meaning of each rating category, the definition of default or recovery and any appropriate risk warning

1122. CESR considers that the objective of this EU requirement – namely, to allow investors and other credit rating users to be informed about the meaning of each rating category, the definition of default or recovery and any appropriate risk warning - is met through the requirement to publicly disclose, on an upfront basis, the "rating determination policy" and the requirement to publicly disclose, on a rating-by-rating basis, information on the objects, assumptions, significance and limitations of the determined credit rating, via the Internet or by any other means. CESR understands that irrespective of the fact that there is no specific provision to disclose any appropriate risk warning, this would in practice be covered by the requirement to provide an explanation of the characteristics of the fluctuation of the credit rating and its limitations. For structured finance products this would include an analysis of loss, cash flow and sensitivity.

Date of first release of the credit rating for publication as well as of its last update

1123. The EU Regulation requires credit rating agencies to indicate clearly and prominently the date at which the credit rating was first released for distribution and when it was last updated.

141 Article 313(2)(iii)(a) of the COOFIN.
142 Article 313(3)(iii)(d) and Article 313(3)(iii)(i) of the COOFIN.

1124. In Japan, the "rating provision policy" to be established, published and adhered to by a credit rating agency pursuant to Article 66-36(1) of the Act needs to provide among other things that:

" in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):

(b) the year, month and date of determining the Credit Rating;
(h) in cases where the Credit Rating Agency does not intend to update the determined Credit Rating, such fact and the grounds therefore"[143].

1125. CESR understands that, for the purposes of the aforesaid provision, the determination of credit ratings includes first release and its update.

Box 51

Date of first release of the credit rating for publication as well as of its last update

1126. CESR considers that the objective of this requirement is met, as credit rating agencies are required to publicly disclose, on a rating-by-rating basis, via Internet or by other means, information on the exact date of determining a credit rating.

Information on whether the credit rating concerns a newly financial instrument and whether the credit rating agency is rating it for the first time

1127. As indicated in paragraph **180** above, for the purposes of assessing the equivalence of a third country legal and regulatory framework, CESR can accept that credit rating agencies in a third country are not specifically required to disclose such information, provided that, as a minimum, it is ensured that attributes and limitations of the credit ratings are disclosed.

1128. In Japan, there is a requirement to disclose, on a rating-by-rating basis, significance and limitations of the determined credit rating, as discussed in paragraph **1134** below.

1129. In addition, as shown by the JFSA's staff answer to Q23e, a credit rating agency is required to disclose information as to whether the credit rating concerns an asset securitisation product whose design deviates from that of products that the credit rating agency has rated in the past, and to adopt measures to verify its ability to adequately determine a credit rating in these circumstances.

1130. This is required by Article 313(3)(iii)(f) of the COOFIN which states that the "rating provision policy" to be established, published and adhered to by credit rating agencies shall provide that:

" in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):

(f) in cases where the object of the Credit Rating is the assessment of the credit status of the Asset Securitization Products, and where the design of such products substantially deviates from the design of Asset Securitization Products that the Credit Rating Agency determined the Credit Rating in the past".

143 Article 313(3)(iii)(b) and 313(3)(iii)(h) of the COOFIN.

1131. In addition, Article 299(xix) of the COOFIN requires a credit rating agency to provide in its application for registration information on:

"(xix) the details of the measures to be implemented to verify the ability of adequately determining a Credit Rating, in cases where the object of the Credit Rating is the assessment of the credit status of Asset Securitization Products (limited to the cases where the design of said Asset Securitization Products substantially deviates from the Asset Securitization Products which were determined Credit Ratings in the past)".

1132. The information referred to in paragraph 1131 is to be provided also in the explanatory documents that credit rating agencies are required to prepare and publish for each business financial year via the Internet.[144]

Attributes and limitation of credit ratings

1133. As can be seen by the JFSA staff answer to Q26, in Japan, there is a requirement to disclose information on the attributes and limitation of the determined credit ratings on a rating-by-rating basis via the Internet or by any other means.

1134. This is required by Article 313(3)(iii)(i) of the COOFIN which states that the "rating provision policy" to be established, published and adhered to by credit rating agencies shall provide that:

" in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):

(i) an explanation on the assumptions, significance and limitations of the determined Credit Rating, in accordance with the category of the object of such Credit Rating (including an explanation on the characteristics of the fluctuation of Credit Ratings; and also including an explanation on the limitations of the Credit Rating, in cases where the object of the Credit Rating is the assessment of the credit status of the financial instruments with limited information on the transition of the credit status)".

Box 52

Attributes and limitation of credit ratings

1135. In Japan there is a requirement to publicly disclose, on a rating-by-rating basis, assumptions, significance and limitations of the determined credit rating, via the Internet or by any other means. CESR therefore considers the objective of this EU requirement to be met.

B. Additional requirements in respect of the presentation and disclosure of credit ratings for structured finance products

1136. As indicated in paragraphs **181** to **186** above, taking into account the complexity of structured finance products, the EU Regulation contains a number of requirements on the disclosure of credit ratings for structured finance products, additional to those generally related to the presentation of any credit ratings.

144 Article 66-39 of the Act and Articles 318(iii)(d)(6) and 319(1) of the COOFIN.

1137. Those additional requirements are designed to ensure that investors and other credit rating users may receive appropriate information regarding credit ratings for such type of products, in view of their complexity.

1138. CESR may accept that the third country legal and regulatory framework does not include identical additional requirements for ratings of structured finance products. However, as stated in paragraph **186** above, CESR considers that, as a minimum, information is to be disclosed about the level of assessment, if any, conducted by the credit rating agency on the due diligence process carried out at the level of underlying financial instruments or other assets of structured finance instruments.

How the Japanese requirements compare to those required for the objectives of the EU requirements to be met

- *Differentiation of ratings for structured products*

1139. As indicated in the JFSA's staff answer to Q22c), in Japan, credit rating agencies are required to differentiate the rating of structured products by adding a specific symbol. However, if the differentiation is not appropriate in terms of ensuring international consistency for a rating symbol, indications that clearly show that the determined credit rating is related to the assessment of the credit status of a structured product are also acceptable.

1140. This is required by Article 313(3)(iii)(f) and Article 313(3)(iii)(k)(2) of the COOFIN which state that the "rating provision policy" to be established, published and adhered to by credit rating agencies shall provide that:

"in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):

(f) in cases where the object of the Credit Rating is the assessment of the credit status of the Asset Securitization Products, and where the design of such products substantially deviates from the design of Asset Securitization Products that the Credit Rating Agency determined the Credit Rating in the past,

(k) the following matters, in cases where the object of the determined Credit Rating was in relation to the assessment of the credit status of the Asset Securitization Products:

(…) 2. the symbols, figures or any other indication for clearly indicating that the object of the determined Credit Rating was the assessment of the credit status of Asset Securitization Products (including an explanation which allows investors to understand the significance and limitations of said Credit Rating based on such symbol)".

1141. Section III-2-3 (1)(vi) of the Guidelines provides that:

"Supervisory departments shall examine the appropriateness of the formulation and disclosure of rating policy, etc. by taking the following points into consideration

(vi) With respect to the rating provision policy, etc., regarding the "symbols, numbers or other notation for clearly stating that the items subject to an determined credit rating are an evaluation pertaining to the credit status of an asset securitization product" (Article 313(3)(iii)(k)(2) of the FIB Cabinet Office Ordinance), whether the credit rating agency uses symbols or numbers that are different to the symbols or numbers pertaining to the credit status of corporations or of financial instruments other than asset securitization products. However, in cases where it is found that using different symbols or numbers would not be appropriate from such perspectives as ensuring international consistency for rating codes, it should be kept in mind that it is also possible to clearly state

that the symbols or numbers are an evaluation pertaining to the credit status of an asset securitization product by using footnotes or other such methods".

- *Information on loss and cash-flow analysis and on expected changes of the credit rating*

1142. As can be seen by the JFSA's staff answer to Q30, in Japan, there is a requirement to disclose, on a rating-by-rating basis, information on the analysis of loss, cash flow and sensitivity of ratings of asset securitisation products, via the Internet or by any other means.

1143. This is required by Article 313(3)(iii)(k)(1) of the COOFIN which states that the "rating provision policy" to be established, published and adhered to by credit rating agencies shall provide that:

"in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):

(k) the following matters, in cases where the object of the determined Credit Rating was in relation to the assessment of the credit status of the Asset Securitization Products:

1. information on the analysis of loss, cash flow and sensitivity".

1144. CESR understands that the disclosure concerning the sensitivity of the credit ratings covers expected changes of the credit ratings.

1145. Pursuant to Article 66-33 of the Act and Article 306(1)(vi)(d) of the COOFIN, a credit rating agency is required to establish operational control systems for the fair and appropriate performance of its credit business, that include measures to secure the proper verification of the appropriateness and effectiveness of a "rating determination policy" for asset securitisation products, in cases of the occurrence of any change to the characteristics of the credit status of the underlying assets of said asset securitisation products.

1146. According to the Guidelines (Section III-2-1 (5)(iv)(b)), the supervisory departments need to examine how credit rating agencies have developed their operational control systems, by taking the following points, for instance, into consideration:

"(a) Whether the credit rating agency has clearly established in advance the criteria for what cases correspond to "cases where there has been a change in the characteristics of the credit status of the assets underlying the asset securitization products," and whether it appropriately examines the validity and effectiveness of rating determination policy, etc. for asset securitization products. Also, whether, in view of market trends and the characteristics of the asset securitization products, the credit rating agency examines the validity of the said criteria in a timely and appropriate manner, and makes revisions as necessary."

- *Information on the assessment conducted concerning due diligence processes at the level of underlying financial instruments*

1147. Credit rating agencies are required to disclose, on a rating-by-rating basis, via Internet or by any other means, information on the measures implemented for the purposes of assuring the quality of the principle information used in the course of determining the credit rating.

1148. This is required by Article 313(3)(iii)(j) of the COOFIN which states that the "rating provision policy" to be established, published and adhered to by a credit rating agency pursuant to Article 66-36(1) of the Act shall provide that:

" in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):

(j) the following matters concerning the principal information used in the course of determining the Credit Rating:
1. an outline of said information;
2. an outline of the measures implemented for the purpose of the quality assurance of said information; and
3. the provider of said information".

1149. CESR understands following additional clarification on this point from the staff of the JFSA that irrespective of the fact that there is no specific requirement to this effect, this disclosure shall include an explanation of:

i. the level of assessment performed by the credit rating agency concerning the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments;

ii. whether the credit rating agency has undertaken any assessment of such due diligence processes or whether it has relied on a third-party assessment. However there is no requirement to disclose how the outcome of such assessment has impacted the credit rating.

1150. In addition, according to Article 66-33 of the Act, a credit rating agency is required to establish operational control systems for the fair and appropriate performance of its credit business.

1151. Pursuant Article 306(1)(ix)(a)(b)(c) of the COOFIN, these operation control systems shall ensure:

"(ix) that the following measures have been 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 the announcement of information on the Asset Securitization Products (including the items announced pursuant to sub-item (a) above);

(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 results thereof (meaning the results of the interviews with the Rating Stakeholders in relation to the status of the disclosure of information on the Asset Securitization Products)".

1152. According to Section III-2-1 (8)(i)(ii) of the Guidelines, supervisory departments need to examine how credit rating agencies have developed their operational control systems, by taking the following points, for instance, into consideration:

"(i) In publicizing "items of information which are deemed important for a third party to assess the validity of the said credit rating" as prescribed in Article 306(1)(ix)(A) of the FIB Cabinet Office Ordinance, whether the credit rating agency has made it possible for a third party to gain an appropriate understanding of the content and risks of asset securitization products. Also, whether the credit rating agency examines the validity of the said items of information in a timely and appropriate manner, and makes revisions as necessary.

(ii) Whether the credit rating agency has clearly established a policy and procedures with respect to approaches to rating stakeholders, encouraging them to take "measures whereby a third party can

examine the validity of the said credit rating" (Article 306(1)(ix)(B) of the FIB Cabinet Office Ordinance), and with respect to the disclosure of the content and results of those approaches (clause (C) of the same article). Also, in addition to appropriately storing records pertaining to the content and results of those approaches, whether the credit rating agency examines the validity and effectiveness of the policy and procedures based on the said records, in a timely and appropriate manner, and makes revisions to the policy and procedures as necessary".

1153. Details of the measures 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 asset securitisation products, are to be provided to the JFSA as part of the application process for registration, according to Article 299(xxiv[145]) of the COOFIN.

1154. The same information needs to be provided in the explanatory documents that credit rating agencies are required to prepare and publish by use of the Internet for each financial year[146].

- *Clear and easily comprehensive guidance accompanying the disclosure of models, methodologies and key assumptions on which ratings for structured products are based*

1155. In Japan there is no specific requirement to accompany the disclosure of methodologies, models and key rating assumptions pertaining to credit rating for structured products with guidance explaining the assumptions, parameters, limits and uncertainties surrounding the models and methodologies used in such credit ratings.

1156. However, as indicated in the JFSA's staff answer to Q33, there is a general requirement for a credit rating agency to disclose in its explanatory documents an outline of the credit determination policies, including the models, methodologies and key rating assumptions. The explanatory documents prepared for each business year shall be made available for public inspection and published via the Internet or by any other method[147].

1157. As indicated in Section III-2-3 (1)(i) of the Guidelines, the description of the credit rating determination policy shall be appropriate and easy to understand for investors and other credit rating users.

- *Disclosure, on an on-going basis, of information about all structured products submitted to the credit rating agency for its initial review or for preliminary rating, even when an issuer does not contract with the credit rating agency for a final rating*

1158. In Japan there is no such requirement. However, as indicated in paragraph **186** above, CESR may accept such a difference in assessing the equivalence of a third country legal and regulatory framework.

Box 53

Additional disclosure requirements in respect of structured finance products

1159. CESR considers the objectives of these EU requirements are met.

145 Please note that there is duplication in the legal text to this number and that this reference can be found on page 10 before Article 299(xxx).
146 Article 66-39 of the Act and Articles 318(iii)(h) and 319(1) of the COOFIN.
147 Article 66-39 of the Act and Article 318(iv) of the COOFIN.

1160. There is a requirement for a distinct labelling of ratings for asset securitisation products. If the differentiation is not appropriate in terms of ensuring international consistency for a rating symbol, indications that clearly show that the determined credit rating is related to the assessment of the credit status of a structured product are also acceptable.

1161. Credit rating agencies are also required to disclose information on (i) the analysis of loss, cash flow and sensitivity of these credit ratings, and (ii) an outline of the measures taken in assuring the quality of the principal information used in determining the credit rating. The information is to be provided on a rating-by-rating basis, via the Internet or by any other means.

1162. CESR understands following additional clarification on this point from the staff of the JFSA that this disclosure needs to include (irrespective of the lack of specific requirements to this effect) an explanation of (i) the level a assessment performed by the credit rating agency concerning the due diligence processes at the level of the underlying financial instruments and (ii) whether the credit rating agency has undertaken any assessment of any such due diligence processes or whether it has relied on a third party assessment. However there is no requirement to disclose how the outcome of such assessment has impacted the credit rating.

1163. Credit rating agencies need to provide in the explanatory documents to be prepared and published for each business year, details of the measures to enable a third party, as an independent party, to verify the appropriateness of the credit rating for asset securitisation products.

1164. The disclosure provided by a credit rating agency concerning the credit determination policies, including the models, methodologies and key rating assumptions for determining credit ratings for structured products, needs to be appropriate and easy to understand for investors and other credit rating users.

Box 54

DISCLOSURE OF CREDIT RATINGS

1165. Overall CESR considers that the Japanese legal and supervisory framework meets all the objectives of the EU requirements in relation to the disclosure of credit ratings for the reasons explained above and set out below for ease of reference

Disclosure of any credit rating, as well as any decisions to discontinue a credit rating, on a non-selective basis and in a timely manner

1166. Credit rating agencies are required: (i) to provide or make available to the public the determined credit ratings without delay; (ii) to announce the intention not to update a determine credit rating and the grounds thereof, and (iii) to provide information on decisions to discontinue credit ratings and the relevant reasons without delay.

Ban to use the name of the competent authority in a way to indicate endorsement or approval of credit ratings

1167. The Japanese legal framework explicitly prohibits credit rating agencies from making any representation regarding the appropriateness of the results of the credit assessment, which may lead to a misperception that such appropriateness has been guaranteed by the JFSA.

Unsolicited credit ratings

1168. **The Japanese framework enables investors and other credit rating users to identify unsolicited credit ratings.**

1169. **The Japanese framework has specific provisions that require a credit rating agency to establish differentiated policies and methods to determine credit ratings in the case of unsolicited credit ratings, which shall be published as part of the "rating determination policy".**

1170. **In addition, when unsolicited credit ratings are provided or made available to the public, the credit rating agency is required to announce by Internet or any other means the fact that the rating is unsolicited as well as information regarding whether the credit rating agency had access to material undisclosed information provided by the rated entity in the credit rating process.**

Explanation of the key elements underlying the credit rating in the press releases or reports

1171. **The Japanese framework enables investors and other credit rating users to be informed about the key elements underlying each credit rating.**

1172. **When credit ratings are provided or made available to the public, there are specific requirements on credit rating agencies to announce by use of Internet or by any other means: (i) an explanation on the assumptions, significance and limitations of the determined credit rating, (ii) information on the objects of the credit rating, (iii) an outline of the criteria and methods used to determine the credit rating, and (iv) an outline of the principal information used to determine credit ratings, the provider of such information and the measures implemented for the purposes of the quality assurance of such information.**

Historical performance data

1173. **The Japanese framework enables investors and other credit rating users to be informed about historical performance data.**

1174. **A credit rating agency is required to include information on the historical data of the determined credit ratings and statistics on the transition of the credit status of the financial instrument or judicial person in the explanatory documents that need to be prepared and published for each business year, on the Internet.**

Details of the lead rating analyst and the person primarily responsible for approving the rating

1175. **A credit rating agency is required, when the determined credit ratings are provided or made available to the public, to announce by use of the Internet or by any other means information on the name of the lead rating analyst who participated in the process for determining the credit rating and of the person who, as a representative of the credit rating agency, is responsible for determining the credit rating.**

1176. **CESR notes that there is a difference with the EU requirement in that in Japan there is no explicit requirement for the job titles to be recorded or publicly disclosed but that**

they will upon request be provided to the JFSA as clearly the credit agency will know the job titles of its employees without having the need for a specific requirement to record this, but CESR does not consider this difference to impact the overall conclusion that the objective of this requirement is met.

Indication of all substantially material sources

1177. The Japanese framework enables investors and other credit rating users to be informed about all material sources used to determine an individual credit rating is met. When a credit rating is published or made available to the public, a credit rating agency is required to disclose, by use of Internet or by another means, an outline of the principal information used in the course of determining that credit rating.

1178. The Japanese framework allows investors and other credit rating users to be informed as to whether a credit rating has been disclosed to the rated entity or its related third party. For each determined credit rating, a credit rating agency is required to publicly disclose, via Internet or by any other means, an outline of the measures implemented for the purposes of the quality assurance of the principal information used in determining that rating. These measures shall include procedures to allow the rated entity to check any factual errors before a determined credit rating is provided or made available to the public.

1179. CESR notes that there is no requirement to indicate whether or not the credit rating was amended following disclosure to the rated entity, this has no impact on CESR's conclusion that the objectives of this EU provision are met.

Indication of the principal methodology or methodology version used

1180. In addition to the general requirement for a credit rating agency to publish upfront its "rating determination policy", there is a requirement to disclose, via Internet or by any other means, the methodology (ies) used to determine a credit rating, on a rating-by-rating basis.

Meaning of each rating category, the definition of default or recovery and any appropriate risk warning

1181. The Japanese framework requires a credit rating agency to publicly disclose, on an upfront basis, the "rating determination policy" and to publicly disclose, on a rating-by-rating basis, information on the objects, assumptions, significance and of the determined credit rating, via the Internet or by any other means. CESR understands that irrespective of the fact that there is no specific provision to disclose any appropriate risk warning, this would in practice be covered by the requirement to provide an explanation of the characteristics of the fluctuation of the credit rating and its limitations. For structured finance products this would include an analysis of loss, cash flow and sensitivity.

Date of first release of the credit rating for publication as well as of its last update

1182. Credit rating agencies are required to publicly disclose, on a rating-by-rating basis, via Internet or by other means, information on the exact date of determining a credit rating.

Attributes and limitation of credit ratings

1183. In Japan there is a requirement to publicly disclose, on a rating-by-rating basis, assumptions, significance and limitations of the determined credit rating, via the Internet or by any other means. CESR therefore considers the objective of this EU requirement to be met.

Additional disclosure requirements in respect of structured finance products

1184. CESR considers the objective of these EU requirements to be met.

1185. There is a requirement for a distinct labelling of ratings for asset securitisation products. If the differentiation is not appropriate in terms of ensuring international consistency for a rating symbol, indications that clearly show that the determined credit rating is related to the assessment of the credit status of a structured product are also acceptable.

1186. Credit rating agencies are also required to disclose information on (i) the analysis of loss, cash flow and sensitivity of these credit ratings, and (ii) an outline of the measures taken in assuring the quality of the principal information used in determining the credit rating. The information is to be provided on a rating-by-rating basis, via the Internet or by any other means.

1187. CESR understands following additional clarification on this point from the staff of the JFSA that this disclosure needs to include (irrespective of the lack of any specific requirements to this effect) an explanation of (i) the level a assessment performed by the credit rating agency concerning the due diligence processes at the level of the underlying financial instruments and (ii) whether the credit rating agency has undertaken any assessment of any such due diligence processes or whether it has relied on a third party assessment. CESR notes that there is no requirement to disclose how the outcome of such assessment has impacted the credit rating, this has no impact on CESR's conclusion that the objectives of this EU provision are met.

1188. Credit rating agencies need to provide in the explanatory documents to be prepared and published for each business year, details of the measures to enable a third party, as an independent party, to verify the appropriateness of the credit rating for asset securitisation products.

1189. The disclosure provided by a credit rating agency concerning the credit determination policies, including the models, methodologies and key rating assumptions for determining credit ratings for structured products, needs to be appropriate and easy to understand for investors and other credit rating users.

General and periodic disclosure about the credit rating agency

1190. This section is aimed at assessing whether the Japanese legal and regulatory framework achieves the objective of the general and periodic disclosure requirements referred to in paragraphs **191**, **193**, **195** and **197** above.

1191. As indicated in paragraph **189** above, the objective of the said requirements is to ensure transparency about credit rating agencies and their activities, to provide investors and other credit rating

users with information to carry out their own assessment on the reliance in the credit ratings as well to furnish the competent authority with information relevant for the purposes of the performance of its supervisory tasks.

1192. As detailed below, in Japan, a credit rating agency is required to publish its rating policy and to prepare and publicly disclose for each business year explanatory documents containing information on: (i) the profile and organisational structure of the credit rating agency, (ii) the status of its business, (iii) the status of organising its operational control system, (iv) the status of its associated juridical persons and subsidiaries, as well as (v) an outline of the "rating policy".

General additional disclosure requirements

Credit rating agency's registration

1193. The EU Regulation requires a credit rating agency to generally disclose to the public the fact that it is registered.

1194. As can be seen by the JFSA's staff answer to Q19a, in Japan, the JFSA has to disclose the names of credit rating agencies that are registered, their registration number and the date of registration[148].

1195. In addition, Article 313(3)(iii)(a) of the COOFIN states that the "rating provision policy" to be established, published and adhered to by a credit rating agency shall provide that:

" in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means (…):
(a) the trade name or name and the registration number of the Credit Rating Agency, and the details of the supervisory measures taken against the Credit Rating Agency in the most recent one year".

1196. In addition, the name, the registration date and registration number of the credit rating agency are to be included in the explanatory documents to be published by the credit rating agency for each business year via the Internet or by other methods that allow easy inspections by investors and credit rating users at any time.[149]

Box 55

Credit Rating Agency Registration

1197. CESR considers the Japanese legal and regulatory framework achieves the objective of the EU requirement to enable investors and other credit rating users to know whether a credit rating agency is registered or not.

1198. The names of the credit rating agencies that are registered, their registration number and the date of registration are publicly disclosed by the JFSA. In addition, there is a requirement for the credit rating agencies to publicly disclose details of their registration via the Internet on a rating-by-rating basis as well as in the explanatory documents to be published for each business year.

148 Article 66-29(1)(i)(ii) of the Act.
149 Article 66-39 of the Act; Article 318(i)(a)(b) and Article 319(1) of the COOFIN.

List of ancillary services

1199. Credit rating agencies are required under the EU Regulation to generally disclose to the public a list of ancillary services they provide.

1200. As can be seen by the JFSA's staff answer to Q19c, in Japan, the registration form shall include information on the type of the credit rating agency's "other business", if any, including ancillary services. As this information is disclosed in the Registry, ancillary services will also be publicly disclosed[150].

1201. In addition, a credit rating agency is required to include in the explanatory documents to be prepared and published for each business year, among other things, information on: (i) the type of its "other business"; (ii) the business conducted in the most recent business year; (iii) the status of ancillary business and other lines of business, and (iv) the measures to be implemented so that activities pertaining to ancillary businesses and other lines of business would not unreasonably affect the credit rating activities[151].

Box 56

List of ancillary services

1202. CESR considers the objective of this requirement is met, taking into account that information on the types of credit rating agency's other business is publicly disclosed through the JFSA's registry as well as by the credit rating agency itself in the explanatory documents to be prepared and published for each business year.

Policy concerning the publication of credit ratings and other relevant communications

1203. As discussed in paragraphs **1041** to **1049** above, a credit rating agency is required to disclose its "rating provision policy" in a manner which allows easy inspection by investors and credit rating users at any time, by means of the use of the Internet or any other means[152].

1204. In addition, an outline of the "rating provision policy" is to be included in the explanatory documents that need to be prepared and published for each business year[153].

Box 57

Policy concerning the publication of credit ratings and other relevant communications

1205. CESR considers that the objective of the EU requirement to enable investors and other credit rating users to be informed about the policy for publication of credit ratings is met, as a credit rating agency is required to disclose its "rating provision policy" on the Internet or through other means which ensure easy inspection by investors and credit rating users at any time.

150 Article 66-28(1)(iv) and Article 66-29(1)(i) of the Act.
151 Article 66-39 of the Act; Article 318(i)(e), Article 318(ii)(a) and Article 318(ii)(b)(5) of the COOFIN. The business report to be provided to the JFSA on an annual basis under Article 66-38 of the Act and Article 316(1) of the COOFIN needs to also include information about the credit rating agency's other lines of business.

152 Article 66-36 of the Act; Article 314(1) and Article 314(3) of the COOFIN.
153 Article 66-39 of the Act and Articles 318(iv) and 319(1) of the COOFIN.

General nature of the compensation arrangements

1206. As can be seen in the JFSA's staff response to Q19e, in Japan, credit rating agencies are required to disclose certain information on the compensation arrangements to both the competent authority and the public.

1207. A credit rating agency is required to implement, as part of its operational control systems, a policy for the determination of the officers and employees' remuneration (meaning any remuneration, bonus or any other property benefit payable as a consideration for the performance of duties), which must not adversely affect the performance of the credit rating business in a fair and adequate manner[154].

1208. Section III-2-1 (9) of the Guidelines states that, in this respect, the JFSA shall consider:

> *"Whether the credit rating agency has properly established a policy for determining the remuneration, etc. of officers and employees, and whether it is applying the policy appropriately. Also, whether the credit rating agency examines, in a timely and appropriate manner, whether the content of the said policy is undermining the fair and appropriate execution of its credit rating business, and whether it makes revisions as necessary."*

1209. A credit rating agency is required to include information on its remuneration policy in its registration form[155].

1210. In addition, the explanatory documents that need to be prepared and published by the credit rating agency for each business year shall include, among other things, the following information:

- the schedule of fees generally applicable between the credit rating agency and the rated entity;

- the measures to be implemented to ensure that the policy for the determination of the remuneration of the credit rating agency's officers and employees would not adversely affect the performance of the credit rating business in a fair and adequate manner[156].

1211. A credit rating agency is also required to prepare and to submit to the JFSA on an annual basis a business report, which includes, among other things, information on the aggregate amount of the remuneration of rating analysts.[157]

Box 58

General nature of the compensation arrangements

1212. CESR considers that the objective of this EU requirement is met, as a credit rating agency is required to publicly disclose on an annual basis information on the fees generally applicable between the credit rating agency itself and the rated entity and the measures to ensure that its remuneration policy would not adversely affect the performance of the credit rating business in a fair and adequate manner.

154 Article 306(1)(x) of the COOFIN.
155 Article 66-28 of the Act and Article 299(xxx) of the COOFIN.
156 Article 66-39 of the Act and Articles 318(ii)(c) and 318(iii)(i) of the COOFIN.
157 Article 66-38 of the Act; Article 316 and Appended Form No 28 of the COOFIN.

Methodologies, models and key rating assumptions and their material changes

1213. As indicated in paragraph 1042 above, credit rating agencies are required to publish their policies and methods for determining the credit ratings ("rating determination policy") by use of the Internet or any other means in a manner that allows easy inspection by investors and other credit rating users[158].

1214. The "rating determination policy" shall include, for each category of credit ratings: (i) the criteria used for identifying the matters which serve as the assumption for the assessment of the credit status, and the criteria used for the setting of grades indicating the results of the assessment of the credit status, and (ii) an outline of the method for the determination of the credit ratings.[159] It shall also provide for the policies and methods for determining unsolicited credit ratings.[160]

1215. In case a credit rating agency intends to effect any material change to its rating determination policy, it shall, in advance, announce the fact that the change will be effected and an outline of such changes. If any unavoidable ground exists, such unavoidable ground, the fact of the change and an outline thereof may be announced without delay after the change.[161]

1216. In addition, as indicated in paragraph **1114** above, an outline of the matter mentioned in paragraph **1214** shall be announced to the public, by means of Internet or other means, on a rating-by-rating basis, when ratings are provided or made available to the public.[162]

1217. An outline of the "rating determination policy" is also required to be included in the explanatory documents that need to be prepared and published by a credit rating agency for each business year.[163]

Box 59

Methodologies, models and key rating assumptions and their material changes

1218. CESR considers that the objective of the EU requirement to allow investors and other credit rating users to be informed about the credit rating agencies methodologies, models and key rating assumptions, and their material changes, is met in Japan.

1219. The upfront requirement for credit rating agencies to publish their rating determination policy is accompanied by an obligation to publish, on a rating-by-rating basis, an outline of the method for determining credit ratings and of the criteria used for identifying rating assumptions and setting the grades.

1220. Credit rating agencies are also required to announce in advance an outline of material changes they intend to effect to their rating determination policy. Where unavoidable ground exists, a material change may be announced without delay after the change.

158 Article 66-36 of the Act and Article 314(1) of the COOFIN.
159 Article 313(2)(iii) of the COOFIN.
160 Article 313(2)(v) of the COOFIN.
161 Article 66-36(1) of the Act and Article 314(3) of the COOFIN.
162 Article 313(3)(iii)(d) of the COOFIN.
163 Article 66-39 of the Act and Article 318(iv) of the COOFIN.

Material modifications to the credit rating agency's systems, resources or procedures

1221. In Japan, changes to the procedures for the issuance and determination of credit ratings are considered as a change in rating policies and need to be disclosed to the public without delay under Article 66-36(1) of the Act.

1222. Other changes to the organisational structure, the governance system and the operational control systems are to be reflected in explanatory documents to be prepared and published by a credit rating agency for each business year via the Internet or by any other method that allows easy inspection by investors and credit ratings users at any time.[164]

Box 60

Material modifications to the credit rating agency's systems, resources or procedures

1223. CESR considers that the objective of the EU requirement is met, since credit rating agencies are required to reflect changes in their organisational structure, governance system and operational control systems in their explanatory documents that need to be prepared and published for each business year.

1224. In addition, changes to the procedures for issuing and determining credit ratings are to be published without delay.

Code of conduct

1225. The Japanese framework requires credit rating agencies to disclose a document describing the code of conduct to be complied with by the credit rating agency and its officers and employees as part of their explanatory documents to be prepared for each business year. The explanatory documents have to be published by use of the Internet or by any other method that allow easy inspection by investors and credit ratings users at any time.[165]

Box 61

Code of conduct

1226. CESR considers that the objective of the EU requirement is met, since a credit rating agency is required to make publicly available in the explanatory documents a description of its code of conduct.

Periodic additional disclosure requirements

List of the 20 largest clients and information on clients who mostly contributed to the grow rate in the generation of their revenue in the previous financial year

164 Article 66-39 of the Act; Article 318(i)(c), Article 318(iii) and Article 319(1) of the COOFIN.
165 Article 66-39 of the Act; Article 318 (iii)(n) and Article 319(1) of the COOFIN.

1227. A credit rating agency is required to disclose on an annual basis the names of the stakeholders from which it receives a rating fee exceeding 10% of the sales volume of its business. The information must be included in the explanatory documents that need to be prepared and published for each business year by use of the Internet or by any other method that allows easy inspection by investors and credit ratings users at any time [166].

1228. As can be seen by the JFSA's staff answer to question 20c, in Japan, there is no requirement to disclose a list of the clients whose contribution to the growth rate in the generation of revenue of the credit rating agency in the previous financial year exceeded the growth rate in the total revenues of the credit rating agency in that year by a factor of more than 1,5 times.

1229. As indicated in paragraph **194** above, for the purposes of assessing equivalence, CESR expects that third country regulatory framework imposes some form of public disclosure regarding revenue generation of the credit rating agency. However, CESR may accept the disclosure requirements applying in the third country regarding the main clients of a credit rating agency not be identical to those set out in the EU Regulation. CESR may also accept that no information is to be disclosed regarding those clients who contributed to the growth rate in the generation of revenue of the credit rating agency by a factor of more than 1,5 times.

Box 62

List of the 20 largest clients and information on clients who mostly contributed to the growth rate in the generation of their revenue in the previous financial year

1230. CESR is satisfied that there is some form of disclosure to the public concerning revenue generation of the credit rating agency.

1231. Although there is no requirement to disclose information regarding those clients who contributed to the grow rate in the generation of revenue of the credit rating agency by a factor of more than 1,5 times, a credit rating agency is required to disclose on an annual basis the names of the stakeholders from which it receives a rating fee exceeding 10% of the sales volume of its business.

Historical default rates of rating categories

1232. A credit rating agency is required to include in the explanatory documents to be prepared for each business year: (i) statistical information or any other information on the transition of the credit status of the financial instruments or juridical persons, and (ii) information on the historical data of the determined credit rating[167]. Information on the historical data of the determined credit ratings is limited to information at the time when one year or more has passed from the day when the credit rating was determined. The explanatory documents shall be published by use of the Internet or by any other method that allow easy inspection by investors and credit ratings users at any time.

1233. As can be seen by the JFSA's staff answer to Q20a (ii), there is no requirement to distinguish such disclosure between the main geographical areas.

166 Article 66-39 of the Act and Articles 318(ii)(2) and 319(1) of the COOFIN. In addition "*the names of the first to twentieth-ranked customers of the Credit Rating Agency, based on descending order of the amount of Rating Fee (meaning the Rating Fee as defined in Article 306 paragraph (1)item (x) sub item(b)) paid to the Credit Rating Agency in the business year, and the amount of the Rating Fee*." Need to be provided to the JFSA in the business report under Article 66-38 of the Act and Article 316(1) and Appended Form 28 of the COOFIN.

167 Article 66-39 of the Act; Article 318(ii)(b)(iii) and Article 318(ii)(b)(iv) of the COOFIN.

1234. As stated in paragraph **196** above, CESR considers that, for the purposes of an equivalence assessment, a third country legal and regulatory framework shall require credit rating agencies to disclose to the public data about historical default rates of rating categories and their changes over time.

1235. However, CESR can accept that the frequency for publication may be different from the one prescribed by the EU Regulation (every six months), as well as that no distinction is required to be made between the geographical areas of the issuers[168].

Box 63

Historical default rates of rating categories

1236. Although the frequency for disclosure is not the same as in the EU Regulation, and there is no requirement to distinguish the disclosure by geographical areas of the issuers, CESR considers that the objective of this EU requirement is met, since credit rating agencies are required to include information on the historical data of the determined credit ratings in their explanatory documents to be prepared and published for each business year.

Legal structure, ownership and revenue streams

1237. Information on the credit rating agency's legal structure, ownership and revenue streams needs to be included in the explanatory documents that a credit rating agency must prepare and publish for each business year by use of the Internet or by any other method that allows for easy inspection by investors and credit ratings users at any time.

1238. The explanatory documents need to contain, among other things, the following information: (i) an outline of the organizational structure, (ii) the names of the officers; (iii) the names and methods of appointment of the members of the Supervisory Committee (including a basic stance on the independence of the independent members); (iv) the name of the first to tenth-ranked shareholders, the number of shares held by such shareholders and the ratio of the number of the voting rights pertaining to such shares to the voting ratings held by all the shareholders; (v) the sale volumes for the most recent business year.[169]

168 Statistics on the transition of a credit status of financial instruments or juridical persons are to be included in the business report that is to be submitted to the JFSA on an annual basis under Article 66-38 of the Act and Article 316(1) and Appended Form 28 of the COOFIN.

169 Article 318(i)(c), Article 318(i)(e); Article 318(i)(d) and Article 318(ii)(b)(1) of the COOFIN.
The explanatory documents shall also include information on the composition of the group of the credit rating agency and information (trade name, locations of the principal business office or office, and principal businesses) of the credit rating agency's associated juridical persons and subsidiaries.Information on(i) the credit rating agencys financial statements(ii) the status of business offices,(iii) the status of shareholders (iv) the status of business needs to be included in the business report to be submitted to the JFSA on an annual basis. This is required under Article 66-38 of the Act and Article 316(1) and Appended Form 28 of the COOFIN.

Box 64

Legal structure, ownership and revenue streams

1239. CESR considers the objective of this EU requirement is met, as a credit rating agency is required to include information about its legal structure, ownership and revenue streams in the explanatory documents that need to be prepared and published for each business year.

Internal control mechanisms ensuring quality of credit rating activities

1240. Credit rating agencies are required to disclose an outline of their rating policy and information on their internal control mechanism ensuring quality of the credit rating activity in their explanatory documents that need to be prepared and published for each business year by use of the Internet or by any other method that allows easy inspection by investors and credit ratings users at any time[170].

1241. This requirement is set out in Article 318(iii) of the COOFIN which provides that the explanatory documents shall include:

"(iii) the status of organizing the operations control system of the Credit Rating Agency (including an outline of the following matters):

a) the measures to be implemented so that a Person in Charge of Rating, as a party independent of a Rating Stakeholder, fairly and faithfully carries out the business, even in cases where such Person in Charge of Rating participates consecutively in the processes of determining Credit Ratings of the matter in which the same Rating Stakeholder has an interest;

b) the measures to be implemented for establishing systems for securing the proper operation of the Rating Agency Services (meaning the measures as set forth in Article 306, paragraph (1), item (iv));

c) the measures for securing Compliance With Laws and Regulations, etc.;

d) the following measures concerning policies on the quality management of the Credit Rating determining process and the implementation thereof:

1. the policy for the recruitment and training of Rating Analysts;

2. the allocation of the Rating Analysts;

3. the measures to be implemented so that the information used for determining a Credit Rating is of sufficient quality;

4. the measures to put in place to properly verify the appropriateness and effectiveness of the Rating Determination Policy, etc.;

5. the measures to be implemented in cases of any material amendment to the Rating Determination Policy, etc., if any, so as to announce, without delay, the scope of the Credit Ratings already determined in accordance with the former Rating Determination Policy, etc. but which require further consideration as to the necessity for being updated in accordance with the amended Rating Determination Policy, etc. and the period of time required for such updating, as well as to update the Credit Ratings within such period of time;

6. the measures to verify the ability of the Credit Rating Agency in Determining a Credit Rating in an appropriate manner, whose object is the assessment of the credit status of Asset Securitization Products (limited to the cases where the design of said Asset Securitization Products substantially deviates from the design of the Asset Securitization Products to which it determined Credit Ratings in the past);

7. The measures so that the Credit Rating Agency will be able to implement the verification and updating of a Credit Rating already determined, in an appropriate manner and on an ongoing basis".

170 Article 318(iii) and Article 318(iv) of the COOFIN.

Box 65

Internal control mechanisms ensuring quality of credit rating activities

1242. CESR considers that the objective of this EU requirement is met, as credit rating agencies are required to disclose an outline of their rating policy as well as information on their internal control mechanism ensuring quality of the credit rating activity in the explanatory documents that need to be prepared and published for each business year.

Record keeping policy

1243. In Japan, a credit rating agency is required to prepare and maintain for at least 5 years the books and documents related to its credit rating business[171] as prescribed by Article 66-37 of the Act and Article 315 of the COOFIN.

1244. A credit rating agency is required to provide in the explanatory documents that need to be prepared and published for each business year information on the measures for securing compliance with laws and regulations that need to be established under Article 306 (1)(v) of the COOFIN[172].

1245. Although there is no explicit requirement to have a record keeping policy, CESR understands that these measures are expected to include a record keeping policy to ensure compliance with the above mentioned record-keeping requirements.

1246. Section III-3-4 (1)(i) of the Guidelines states that for books and documents the supervisory departments needs to consider:
"Whether the credit rating agency has stipulated in its internal rules, etc. specific methods for preparing and storing the books and documents listed in Article 315 of the FIB Cabinet Office Ordinance."

1247. In addition, Section III-3-4 (2)(ix) of the Guidelines that:

"Persons responsible for creation and storage shall be assigned, and internal rules on the said creation and storage shall be developed."

Box 66

Record keeping policy

1248. Credit rating agencies are required to publicly disclose in their explanatory documents information on the measures for securing compliance with laws and regulations.

1249. Although there is no explicit requirement for a credit rating agency to have a record keeping policy, CESR understands that these measures are expected to include a policy to comply with the record-keeping requirements imposed by the Act and the COOFIN. The supervisory departments consider in their supervision over credit rating agencies whether or not a record-keeping policy has been established among the internal rules of the credit rating agency.

1250. CESR therefore considers that the objective of this requirement is met.

171 Article 66-37 of the Act and Article 315 of the COOFIN.
172 Article 66-39 of the Act and Article 318(iii)(c) of the COOFIN.

Management and rotation policy

1251. As indicated in paragraphs **1240** and **1241** above, a credit rating agency is required to provide, in the explanatory documents that need to be prepared and published for each business year, information on the measures to be implemented so that a person in charge of rating, as a party independent of a rating stakeholder, fairly and faithfully carries out the business.[173]

1252. As indicated in paragraphs **964** et seq. above, such measures shall include one of the following options: 1) rotation of lead analysts (five years with an interval of two years); or 2) making final decisions on credit ratings at the rating committee, while preventing at least one-third of the total members of the said committee from being successively involved in processes pertaining to the determination of credit ratings of the same rating stakeholder.

1253. Section III-2-1 (1) of the Guidelines states that, in this respect, supervisory departments shall examine how credit rating agencies have developed their:

"measures pertaining to instances where a person in charge of rating is consecutively involved in processes relating to the determination of a credit rating on a matter in which the same rating stakeholder has an interest (rotation rule):

"(i) Whether the credit rating agency has clearly established in advance whether it will use both or select one of either of the measures prescribed in Article 306(1)(ii)(A) or (B) of the FIB Cabinet Office Ordinance (and the application criteria of each measure in cases where it uses both).

(ii) Whether the credit rating agency has properly recorded and stored credit ratings in which a lead rating analyst or a member of the credit rating committee (refers to the consultative body which makes the final decision for the credit rating agency regarding the determination of credit ratings; the same shall apply hereinafter) has been involved in the rating process, so that it can properly adhere to the measures prescribed in Article 306(1)(ii)(A) or (B) of the FIB Cabinet Office Ordinance."

1254. The explanatory documents also need to include information on the measures adopted for securing compliance with laws and regulations[174].

Box 67

Management and rotation policy

1255. CESR considers that the objective of this EU requirement is met.

1256. A credit rating agency is required to include in the explanatory documents prepared and published for each business year information on the measures for securing compliance with laws and regulation, as well as on the measures to be implemented so that a person in charge of rating fairly and faithfully carries out the business. The above measures shall include either a rotation of lead analysts or a rotation of members of the rating committee making final decisions on credit ratings.

Statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management

173 Article 66-39 of the Act and Article 318(iii)(a) of the COOFIN.
174 Article 66-39 of the Act and Article 318(iii)(c) of the COOFIN.

1257. Information on the allocation of the rating analysts is to be included in the explanatory documents a credit rating agency is required to prepare and publish for each business year, as set out in paragraphs **1240** and **1241**[175].

1258. The explanatory documents shall also contain information on senior management, namely: (i) the names of the credit rating agency's officers, and (ii) the operational policies of the Supervisory Committee and the names and methods of appointment of its members (including a basic stance on the independence of the independent members)[176].

1259. The explanatory documents must include also data on credit rating reviews. As referred to in paragraph **1232** above, the explanatory documents shall provide: (i) statistical information or any other information on the transition of the credit status of the financial instruments or juridical persons, and (ii) information on the historical data of the determined credit rating[177].

1260. Although there is no specific requirement to publish statistics on methodologies or model appraisals, a credit rating agency is required to disclose in its explanatory documents an outline of the rating policy and a description of: (i) the measures to be put in place to properly verify the appropriateness and effectiveness of the "rating determination policy", (ii) the measures to be put in place in case of any material change to the "rating determination policy", and (iii) the measures so that the credit rating agency will be able to implement the verification and updating of a credit rating that has already been determined, in an appropriate manner and on an ongoing basis" .[178]

1261. CESR understands following additional clarification on this point from the staff of the JFSA that the review needs to be conducted on an ongoing basis and every time material changes are made or to be made, the credit rating agency needs to publish the material change without delay.

Box 68

Statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management

1262. Credit rating agencies are required to publicly disclose on an annual basis in their explanatory documents information on: (i) the allocation of the rating analysts, (ii) the senior management; (iii) historical data of their credit ratings and transition of the credit status of the financial instruments or juridical persons.

1263. Although credit rating agencies are not required to disclose statistics on credit rating reviews, methodologies or model appraisals, they are required to provide in the explanatory documents an outline of their "rating determination policy" as well as a description of the measures to be implemented to allow for an appropriate verification of their "rating determination policy".

1264. CESR understands following additional clarification on this point from the staff of the JFSA that the review needs to be conducted on an ongoing basis and every time material changes are made or to be made, the credit rating agency needs to publish the material change without delay.

1265. In light of the above, CESR considers that the objectives of these EU requirements are met and considers that the provisions in Japan in this area are similar to that of the EU Regulation.

175 Article 66-39 of the Act and Article 318(iii)(d)(2) of the COOFIN.
176 Article 66-39 of the Act; Article 318(i)(e) and Article 318(iii)(m) of the COOFIN.
177 Article 66-39 of the Act; Article 318(ii)(b)(iii) and Article 318(ii)(b)(iv) of the COOFIN.
178 Article 66-39 of the Act; Article 318(iii)(d)(4), Article 318(iii)(d)(7) and Article 318(iv) of the COOFIN.

Outcome of the annual internal review of their independent compliance function

1266. Credit rating agencies are required to include, in the explanatory documents that need to be prepared and published for each business year, information on the status of organising their operational control system, including information on the measures for securing compliance with laws and regulations[179].

1267. The measures to be implemented for securing compliance with laws and regulations are set in Article 306(1)(v) of the COOFIN.

1268. The explanatory documents need to also contain information on the measures to be implemented so as to appropriately and swiftly address complaints raised against the credit rating agency and to prevent conflicts of interest.[180]

1269. In addition, credit rating agencies are required to prepare and maintain for at least 5 years documents describing the results of an investigation on the status of compliance with laws and regulations.[181]

Box 69

Outcome of the annual internal review of their independent compliance function

1270. CESR considers that the objective of the EU requirement is met, as credit rating agencies are required to include in the explanatory documents that need to be prepared and published for each business year information on the status of organising their operation control system, including information on the measures for securing compliance with laws and regulations.

Box 70

GENERAL AND PERIODIC DISCLOSURE ABOUT CREDIT RATING ACTIVITIES

1271. CESR considers that the Japanese legal and supervisory framework meets all the objectives of the EU disclosure requirements for the reasons explained above and set out below for ease of reference.

Credit Rating Agency Registration

1272. The Japanese legal and regulatory framework enables investors and other credit rating users to know whether a credit rating agency is registered or not.

179 Article 66-39 of the Act and Article 318(iii)(c)of the COOFIN.
180 Article 66-39 of the Act; Article 318 (iii)(e) and 318(iii)(l) of the COOFIN.
181 Article 66-37 of the Act and Article 315 (1)(v) of the COOFIN.

1273. The names of the credit rating agencies that are registered, their registration number and the date of registration are publicly disclosed by the JFSA. In addition, there is a requirement for the credit rating agencies to publicly disclose details of their registration via the Internet on a rating-by-rating basis as well as in the explanatory documents to be published for each business year.

List of ancillary services

1274. Information on the types of credit rating agency's other business is publicly disclosed through the JFSA's registry as well as by the credit rating agency itself in the explanatory documents to be prepared and published for each business year.

Policy concerning the publication of credit ratings and other relevant communications

1275. The Japanese legal and regulatory framework enables investors and other credit rating users to be informed about the policy for publication of credit ratings, as a credit rating agency is required to disclose its "rating provision policy" on the Internet or through other means which ensure easy inspection by investors and credit rating users at any time.

General nature of the compensation arrangements

1276. A credit rating agency is required to publicly disclose on an annual basis information on the fees generally applicable between the credit rating agency itself and the rated entity and the measures to ensure that its remuneration policy would not adversely affect the performance of the credit rating business in a fair and adequate manner.

Methodologies, models and key rating assumptions and their material changes

1277. The Japanese legal and regulatory framework enables investors and other credit rating users to be informed about the credit rating agencies methodologies, models and key rating assumptions, and their material changes.

1278. Credit rating agencies are required to publish their rating determination policy and this is accompanied by an obligation to publish, on a rating-by-rating basis, an outline of the method for determining credit ratings and of the criteria used for identifying rating assumptions and setting the grades.

1279. Credit rating agencies are also required to announce in advance an outline of material changes they intend to effect to their rating determination policy. Where unavoidable ground exists, a material change may be announced without delay after the change.

Material modifications to the credit rating agency's systems, resources or procedures

1280. Credit rating agencies are required to reflect changes in their organisational structure, governance system and operational control systems in their explanatory documents that need to be prepared and published for each business year.

1281. In addition, changes to the procedures for issuing and determining credit ratings are to be published without delay.

Code of conduct

1282. A credit rating agency is required to make publicly available in the explanatory documents a description of its code of conduct.

Periodic Additional Disclosure Requirements

List of the 20 largest clients and information on clients who mostly contributed to the growth rate in the generation of their revenue in the previous financial year

1283. CESR is satisfied that there is some form of disclosure to the public concerning revenue generation of the credit rating agency.

1284. Although there is no requirement to disclose information regarding those clients who contributed to the grow rate in the generation of revenue of the credit rating agency by a factor of more than 1,5 times, a credit rating agency is required to disclose on an annual basis the names of the stakeholders from which it receives a rating fee exceeding 10% of the sales volume of its business.

Historical default rates of rating categories

1285. Although the frequency for disclosure is not the same as in the EU Regulation, and there is no requirement to distinguish the disclosure by geographical areas of the issuers, CESR considers that the objective of this EU requirement is met, since credit rating agencies are required to include information on the historical data of the determined credit ratings in their explanatory documents to be prepared and published for each business year.

Legal structure, ownership and revenue streams

1286. A credit rating agency is required to include information about its legal structure, ownership and revenue streams in the explanatory documents that need to be prepared and published for each business year.

Internal control mechanisms ensuring quality of credit rating activities

1287. Credit rating agencies are required to disclose an outline of their rating policy as well as information on their internal control mechanism ensuring quality of the credit rating activity in the explanatory documents that need to be prepared and published for each business year.

Record keeping policy

1288. Credit rating agencies are required to publicly disclose in their explanatory documents information on the measures for securing compliance with laws and regulations.

1289. Although there is no explicit requirement for a credit rating agency to have a record keeping policy, CESR understands that these measures are expected to include a policy to comply with the record-keeping requirements imposed by the Act and the COOFIN. The supervisory departments consider in their supervision over credit rating agencies whether or not a record-keeping policy has been established among the internal rules of the credit rating agency.

Management and rotation policy

1290. A credit rating agency is required to include in the explanatory documents prepared and published for each business year information on the measures for securing compliance with laws and regulation, as well as on the measures to be implemented so that a person in charge of rating fairly and faithfully carries out the business. The above measures shall include either a rotation of lead analysts or a rotation of members of the rating committee making final decisions on credit ratings.

Statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management

1291. Credit rating agencies are required to publicly disclose on an annual basis in their explanatory documents information on: (i) the allocation of the rating analysts, (ii) the senior management; (iii) historical data of their credit ratings and transition of the credit status of the financial instruments or juridical persons.

1292. Although credit rating agencies are not required to disclose statistics on credit rating reviews, methodologies or model appraisals, they are required to provide in the explanatory documents an outline of their "rating determination policy" as well as a description of the measures to be implemented to allow for an appropriate verification of their "rating determination policy".

1293. CESR understands following additional clarification on this point from the staff of the JFSA that the review needs to be conducted on an ongoing basis, and that every time material changes are made or to be made, the credit rating agency needs to publish the material change without delay.

1294. CESR considers that the provisions in Japan in this area are similar to the EU Regulation.

Outcome of the annual internal review of their independent compliance function

1295. Credit rating agencies are required to include in the explanatory documents that need to be prepared and published for each business year information on the status of organising their operation control system, including information on the measures for securing compliance with laws and regulations.

G. Effective supervision and enforcement

1296. In establishing the equivalence of the Japanese regulatory and supervisory framework to that of the EU Regulation, as explained in paragraph **214** above, CESR considers that all the powers that an EU competent authority needs to have and all the measures that it needs to be able to take, as set out in the EU Regulation, need to be firmly embedded in the relevant third country law in order for CESR to be able to classify the third country regime as having effective supervision and enforcement that can be considered as equivalent in place.

1297. These powers and measures are as set out in paragraphs **212** and **213** above.

1298. The necessary powers that the authority needs to have is the power to:

a) Access to any document in any form and to receive or take a copy thereof;
b) Demand information from any person and if necessary to summon and question a person with a view to obtaining information);
c) Carry out on-site inspections with or without announcement;
d) Require records of telephone and data traffic.

1299. In addition, the authority needs to be able to take the following measures against a credit rating agency following the establishment of a breach by it in respect of its obligations under the EU Regulation:

a) Withdraw the credit rating agency's registration or authorisation;
b) Prohibit the credit rating agency from temporarily, issuing credit ratings;
c) Suspend the use of credit ratings issued by the credit rating agency for regulatory purposes;
d) Take appropriate measures to ensure that the credit rating agency continues to comply with its legal requirements;
e) Issue public notices where the credit rating agency is in breach of its obligations arising from the relevant regulatory framework in your jurisdiction; and
f) Refer matters for criminal prosecution to the relevant national judicial authorities.

1300. This section explains: (i) the JFSA's powers, (ii) the measures that it can take, (iii) the penalties that it can impose, (iv) the divisions and offices of the JFSA responsible for the supervision and enforcement of the credit rating agencies' laws and regulations, and (v) how the JFSA ensures adequate staffing.

1301. This section is divided as follows:

a) Divisions and offices of the JFSA responsible for the oversight and supervision of credit rating agencies;
b) JFSA's personnel;
c) Prohibition to influence the content of ratings and credit rating agencies' methodologies;
d) Powers of the JFSA;
e) Sanctions.

Divisions and offices of the JFSA responsible for the oversight and supervision of credit rating agencies

1302. This part of the report describes the internal organisation currently adopted by the JFSA to discharge its supervisory tasks over credit rating agencies.

1303. If deemed appropriate, the JFSA may decide in the future to strengthen its internal organisation regarding oversight and supervision of credit rating agencies.

(i) Registration and on-going monitoring

1304. Within the Securities Business Division of the JFSA, there are currently 3 individuals dedicated to routine supervision of credit rating agencies. These individuals – who are not organised as a separate department - are responsible for the assessment of initial applications for registration as well as for the on-going monitoring of credit rating agencies.

1305. The Commissioner of the JFSA needs, in principle, to make a decision regarding initial applications within two months[182]. In assessing initial applications, it is to be verified that all the requirements are met at time of application. Conditional registrations are not expected. Additional information can be required in the registration process, including through meetings with representatives of the credit rating agency, as deemed appropriate.

1306. The approach envisaged by the JFSA in relation to routine supervision of credit rating agencies is set out in the Guidelines, which include points of focus and attention when conducting supervision and specific supervisory techniques.[183]

1307. The Guidelines are not expected to be applied in a mechanical and uniform fashion, but an assessment is to be made on a case-by-case basis from the viewpoint of protecting public interests and investors.[184]

1308. On-going monitoring activities are aimed at verifying that credit rating agencies ensure thorough legal compliance, including the development of operational control systems for conducting their credit rating business fairly and appropriately.

1309. As stated in the Guidelines[185], ways of achieving this include properly grasping the state of business operations of credit rating agencies through periodic and continuous hearings and other means, and accumulating and analysing various data and information provided by the credit rating agencies, encouraging them to make voluntary improvement efforts in order to ensure the appropriateness of their business.

1310. Any features identified during the registration process are taken into account and monitored in the course of on-going monitoring activities. Significant criteria changes and default rates are also duly monitored. Where appropriate, other information about the credit rating agencies are taken into account.

1311. Off-site monitoring by the Securities Business Division of the JFSA play an important role in supervision. Meetings with the credit rating agencies are arranged to informally go through about the contents of the business reports to be disclosed by the credit rating agency for each business year in

182 Article 328 of the FIB Cabinet Office Ordinance.
183 Section I-2 of the Guidelines.
184 Section I-2 of the Guidelines.
185 Section I-1 of the Guidelines.

accordance with Article 66-38 of the Act and Article 316 and the Appended Form No. 28 of the COOFIN.

1312. The business reports need, among other things, to contain detailed information about the credit rating activities and ancillary business conducted in the business year, the total number of officers and employees, the number of rating analysts and the aggregate amount of their remuneration, the number of credit ratings determined for each category of credit ratings and the names of the first to twentieth-ranked clients.

1313. Information included in the rating provision policy concerning disclosure of individual credit ratings is also duly checked.

(ii) On-site inspections

1314. On-site inspections over credit rating agencies are currently entrusted to the Inspection Division of the Securities and Exchange Surveillance Commission ("SESC"). This applies to both routine inspections and inspections that relate to investigations on administrative cases.

1315. When the inspection relates to an investigation on criminal cases, the Investigation Division of the SESC may investigate credit rating agencies.

1316. The SESC is a separate commission under the JFSA, with independent decision making powers. However, the budget and staffing of the SESC are still within the scope of the JFSA's Commissioner.

1317. The SESC's programme of inspections over credit rating agencies has not been defined yet.

1318. The outcomes of SESC's on-site inspections over credit rating agencies are transmitted to the Securities Business Division of the JFSA, which has the power to require additional information or conduct a hearing of the relevant credit rating agency to assess the outcomes of the inspection. The JFSA's Securities Business Division may propose to the Commissioner of the JFSA to take supervisory actions.

(iii) Enforcement

1319. If the SESC was to find any problems that it considered needed to be addressed and improved upon through the inspections, it may notify these issues to the credit rating agency by its confidential notices.

1320. In cases where the SESC was to find serious misconduct by the credit rating agency, it would report the outcomes of the inspection to the JFSA's Securities Business Division, which may propose to the Commissioner of the JFSA that administrative disciplinary actions and other necessary measures are taken.

JFSA's Personnel

1321. The JFSA determines appropriate staffing levels for the division responsible for the supervision of credit rating agencies (including the staffing level for the SESC).

1322. As of end-March 2010, there are 35 people in the Securities Business Division, Supervisory Bureau of the JFSA, of which 3 people are dedicated to credit rating agencies' supervision.

1323. In addition, there are over hundred people in the Inspection Division of the SESC, of which around 10 people – not organised as a separate office - will be in charge of inspections on credit rating agencies. The Investigation Division of the SESC may investigate credit rating agencies for investigations pertaining to criminal cases. As of the end of March 2010 the number of staff in the Investigation Division of the SESC is 103.

1324. As indicated by the JFSA in its answer to Q39, "Additional sections for the implementation of the CRA regulation have been and are to be established for legislation, supervision and inspection. Staff with adequate expertise and experiences have been and are to be allocated to such section".

Prohibition to influence the content of ratings and credit rating agencies' methodologies

1325. Like the EU Regulation, the Japanese regulatory framework contains a rule that prohibits the JFSA, when exercising its statutory authority over credit rating agencies, to influence the content of ratings or credit rating agencies' methodologies.

1326. Namely, Article 325 of the COOFIN provides that, in cases whether the Commissioner of the JFSA exercises the authority:

a) to order an improvement of the status of business operations under Article 66-41 of the Act;

b) to rescind the registration of a credit rating agency or to order suspension of all or part of its business or a dismissal of a credit rating agency's officer under Articles 66-42 (1) and 66-42 (2) of the Act; or

c) to order the submission of reports or inspections under Article 66-45(1) of the Act,

this Commissioner shall pay attention not to be involved in the individual credit ratings or the specific details of the method of credit assessment.

1327. The Guidelines point out that "*the approach that has been taken is that it would be inappropriate to make the actual substance of individual credit ratings subject to regulation"* and that the *"supervisory departments shall act while giving due consideration"* to compliance with the said Article 325 of the COOFIN.[186]

Powers of the JFSA

1328. According to Articles 66-41, 66-42 and 66-45 of the Act, the Prime Minister can exercise a wide range of powers over credit rating agencies in the public interest or for the protection of investors.

1329. According to Article 194-7 of the Act, the Prime Minister shall delegate to the Commissioner of the JFSA the authority vested under the Act.

1330. The powers to require the submission of documents and to demand information may be exercised by both the Commissioner of the JFSA and the SESC.

1331. The power to carry out on-site inspections is exercised by the SESC but, under limited circumstances, may be exercised by the Commissioner of the JFSA as well.

1332. The power to require credit rating agencies to provide records of telephone and data traffic can be exercised by both the Commissioner of the JFSA and the SESC, through a request for information or inspections.

186 Section I-1 of the Guidelines.

1333. Criminal sanctions (as discussed below) are applied by application to the judicial authorities.

1334. As described below, these powers cover all the powers that EU competent authorities must have according to Article 23(3) of the EU Regulation.

(i) Power to access to any document in any form and to receive or take a copy thereof

1335. Pursuant to Article 66-45 of the Act, the Commissioner of the JFSA has the power to require or inspect reports or materials that will be helpful for understanding the business of the credit rating agency, whenever it finds it necessary and appropriate for the public interest or the protection of investors.

1336. CESR understands following further clarification of this point from the staff of the JFSA that this power includes the authority to have access to, or receive or make copy of, any document necessary to verify compliance with the credit rating agencies' regulation. No limitations apply with regard to the scope of reports to which the JFSA may have access to.

1337. There is no legal definition of "public interest". The protection of public interest and investors are the general purposes of the Act[187] and therefore shall drive the supervisory activities carried out by the JFSA.

1338. The above-mentioned power may be exercised vis-à-vis the credit rating agency itself, as well as towards a person who conducts transactions with the credit rating agency, a person who has received entrustment of business from the credit rating agency, or the associated juridical person[188] of the credit rating agency, as long as it is for the purpose of the inspection/supervision of the credit rating agency.

1339. CESR understands following clarification of this point with the staff of the JFSA that the above power can in practice be exercised towards the credit rating agency, those involved in credit rating activities including officers, those with whom the credit rating agency has entered into outsourcing arrangements, the rated entity and the related third party (but in respect of the rated entity and related third party, only in the case that the rated entity has entered into a business transaction with the credit rating agency with respect to a credit rating – such as for example in the case of solicited ratings).

1340. According to Articles 194-7(2) and 194-7(3) of the Act, the Commissioner of the JFSA shall delegate to the SESC the authority vested under the said Article 66-45 of the Act. However, this does not preclude the Commissioner of the JFSA from exercising his/her authority to issue an order of submission of reports or materials.

187 According to Article 1, the Act aims at contributing "to the sound development of the national economy and protection of investors."

188 According to Article 66-45 of the Act, "Such Associated Juridical Person" means "the Subsidiary Juridical Person of the Credit Rating Agency, a juridical person who has the Credit Rating Agency as its Subsidiary Juridical Person or a Subsidiary Juridical Person of the juridical person who has the Credit Rating Agency as its Subsidiary Juridical Person (excluding the Credit Rating Agency) who is a juridical person that conduct acts of determining Credit Ratings, or providing them to someone or making them available to the public in the course of trade".
The term "Subsidiary Juridical Person" means "another juridical person, the majority of whose Voting Rights Held by All the Shareholders, etc. are held by a juridical person. In this case, the other juridical person, the majority of whose Voting Rights Held by All the Shareholders, etc. are held by the juridical person and one or more of its Subsidiary Juridical Persons or by one or more of the Subsidiary Juridical Person of the juridical person, shall be deemed as a Subsidiary Juridical Person of said juridical person."

(ii) Power to demand information from any person and, if necessary, to summon and question a person with a view to obtaining information

1341. The Commissioner of the JFSA is empowered, under Article 66-45 of the Act, to require information that will be helpful for the understanding of the business of the credit rating agency, whenever it finds it necessary and appropriate for the public interest or the protection of investors.

1342. The power can be exercised towards the persons referred to in paragraph **1338** above.

1343. According to Articles 194-7(2) and 194-7(3) of the Act, the Commissioner of the JFSA shall delegate to the SESC the authority vested under the said Article 66-45 of the Act. However, this does not preclude the Commissioner of the JFSA from exercising his/her authority to demand information.

1344. In addition, the SESC has the power to require a suspect or witness to appear, to question a suspect or to inspect a suspect's documents, to inquire public agencies or public or private organisations about the investigation and require them to report necessary matters, for investigations pertaining to market misconduct or disclosing false information according to Article 210 of the Act[189].

(iii) Power to carry out on-site inspections with or without announcement

1345. Pursuant to Article 66-45 of the Act, the Commissioner of the JFSA has the authority to inspect the status of the business, documents, or other articles of the credit rating agency, whenever it finds it necessary and appropriate for the public interest or the protection of investors.

1346. The power to carry out on-site inspections can be exercised also towards persons who received entrustment of business from the credit rating agency and associated juridical person of the credit rating agency, but the inspection shall be limited to what is necessary in order to understand the business of the credit rating agency.

1347. CESR understands following additional clarification on this point from the staff of the JFSA that inspections can be carried out with or without announcement.

1348. According to Articles 194-7(2) and 194-7(3) of the Act, the Commissioner of the JFSA shall delegate to the SESC the authority to carry out on-site inspections vested under the said Article 66-45 of the Act. However, this does not preclude the Commissioner of the JFSA from exercising his/her authorities to conduct on-site inspections.

1349. On-site inspections are carried out primarily by the Inspection Division of the SESC. In addition when it comes to an investigation on criminal cases, the Investigation Division of the SESC may investigate credit rating agencies.

1350. Considering that the new legal and supervisory framework entered into force only on April 1st, 2010[190], no data is available regarding inspections carried out on credit rating agencies.

189 Namely, Article 210 of the Act provides that an official of the SESC has, among other, the authority to request a suspect or witness to appear, when it is necessary for investigating a criminal case that pertain to what are specified by a Cabinet Order as crimes that harm the fairness of sales and purchase or other transactions of securities or derivative transactions.

190 With the exception of the new disclosure obligation on broker-dealers to provide additional explanations to their clients in relation to credit ratings issued by a an entity that this not registered as a credit rating agency with the JFSA, which will become effective as of October 1st, 2010.

(iv) Power to require records of telephone and data traffic

1351. As can be seen by the staff of the JFSA's answer to question 43, as the secrecy of communication is constitutionally guaranteed, an authority in Japan cannot normally acquire records of telephone and data traffic from telephone companies.

1352. However, the Commissioner of the JFSA and the SESC have the authority to acquire records of telephone and data traffic from the credit rating agencies themselves through a request of information or inspections.

1353. The authority is based on the provisions of the above-mentioned Article 66-45 of the Act and the power can be exercised towards the persons referred to in paragraph **1338** above.

(v) Power to withdraw the credit rating agency's registration or authorisation

1354. The Commissioner of the JFSA has the authority to withdraw the credit rating agency's registration in the cases provided for under Article 66-42 of the Act.

1355. Namely, the power can be exercised in the following circumstances:

a) when the credit rating agency has come to fall under any of the following cases:

i. a person other than a juridical person;
ii. a juridical person who falls under Article 29-4, paragraph (1), sub-item (a) or (b) of the Act[191];
iii. a juridical person whose other business is found to be against the public interest;
iv. a juridical person who is found not to have established a system necessary for the fair and appropriate performance of the credit rating business.

b) when the credit rating agency has come to fall under the grounds upon which the registration shall be refused under Article 66-30(2) of the Act[192];
c) when the credit rating agency has obtained the registration by wrongful means;
d) when the credit rating agency has violated laws and regulations or dispositions given by a government agency based on laws and regulations with regard to its credit rating business;
e) when there are facts that undermine the investors' interest with regard to the operations of credit rating business; or
f) when a wrongful act or extremely unjust act has been conducted with regard to credit rating business, and when the circumstances are especially serious.

1356. CESR understands following additional clarification on this point from the staff of the JFSA that, although a violation of the duty of good faith or of the requirements concerning the operational con-

191 Article 29-4(1)(a) of the Act refers to cases of withdrawal of: (i) registration as "financial instruments business operator", (ii) permission to a foreign securities broker to carry out sales and purchases of securities and market transactions of derivatives on a Financial Instruments Exchange; (iii) registration as a "financial instrument intermediary service", or (iv) registrations or licenses of the same kind granted under the provisions of foreign laws and regulations equivalent to the Act, when five years have not passed since the date of the withdrawal.
Article 29-4(1)(b) of the Act refers to cases of persons punished by a fine for violating the provisions of the Act and other Japanese laws, when five years have not passed since the date when the punishment terminated and/or the relevant person become free from the execution of he punishment.

192 Article 66-30(2) of the Act states that "The Prime Minister shall, in addition to what is provided for in the preceding paragraph, refuse the registration when the applicant for registration has no business office or office in Japan in cases where the applicant for registration is a foreign juridical person; however, this shall not apply in cases specified by Cabinet Office Ordinance as such where the relevant applicant for registration is deemed to be subject to appropriate supervision of an administrative agency in foreign jurisdiction which supervises the person who conducts business deemed to correspond to Credit Rating Business, or any other organization equivalent to such agency, or in cases where the refusal of registration under the main clause of this paragraph shall preclude sincere implementation of treaties or any other international agreement."

trols systems, the prohibited acts and the rating policy – set out respectively by Articles 66-32, 66-33, 66-35 and 66-36 of the Act - does not result per se in the application of a sanction, a breach of any of such Articles may result in a decision to withdraw the credit rating agency's registration under the above-mentioned Article 66-42 of the Act.

1357. A public notice of the withdrawal is to be given according to Article 66-43 of the Act.

(vi) Power to prohibit the credit rating agency from temporarily issuing credit ratings

1358. Pursuant to 66-42 of the Act, the Commissioner of the JFSA has the authority to suspend, in whole or in part, the business of a credit rating agency for a period not exceeding 6 months.

1359. The power can be exercised in the circumstances described in paragraph **1355** above.

1360. CESR understands following additional clarification on this point from the staff of the JFSA that, although a violation of the duty of good faith or of the requirements concerning the operational controls systems, the prohibited acts and the rating policy – set out respectively by Articles 66-32, 66-33, 66-35 and 66-36 of the Act - does not result per se in the application of a sanction, a breach of any of such Articles may result in a suspension, in whole or in part, of the credit rating agency's business.

1361. If a credit rating agency violates such suspension, the sanctions discussed in paragraph **1382** letter **b)**, and paragraph **1385** letter **a)** below may also apply.

1362. A public notice of the suspension is to be given according to Article 66-43 of the Act.

(vii) Power to suspend the use of credit ratings for regulatory purposes

1363. As indicated by the JFSA in its answer to question 44, the uses of credit ratings for regulatory purposes are stipulated in Cabinet Office Ordinances and Notifications[193] and are planned to be reviewed.

1364. A suspension of the use of credit ratings for regulatory purposes will be ensured by the withdrawal of the credit rating agency's registration which will have the effect in practice of suspending any credit rating issued by the credit rating agency.

1365. CESR understands following additional clarification on this point from the staff of the JFSA that in the future the JFSA will have the authority to impose additional conditions relating to the suspension of the use of credit ratings issued by a credit rating agency for regulatory purposes, by amending relevant Cabinet Office Ordinances and Notifications, however CESR understands that it is unlikely that the use of a credit rating for regulatory purposes will be suspended without withdrawing the credit rating agency's registration.

193 Cabinet Office Ordinance on Financial Instruments Business etc.; Ordinance for Enforcement of Insurance Business Law; Cabinet Office Ordinance on Disclosure of Corporate Information, etc; Cabinet Office Ordinance on Disclosure of Information etc. on Issuers of Foreign Government Bonds, etc; Cabinet Office Ordinance on Disclosure of Information, etc. on Specified Securities; Order on Bank's Shareholdings Purchase Corporation; Ordinance for Enforcement of Act on Securitisation of Assets; Ordinance on Accountings of Investment Trust Properties; Ordinance for Enforcement of Act on Securities Investment Trust and Securities Investment Corporations.

(viii) Power to take appropriate measures to ensure that the credit rating agency continues to comply with is legal requirements

1366. The Commissioner of the JFSA has the authority to take appropriate measures to ensure that a credit rating agency continues to comply with is legal requirements pursuant to Article 66-41 of the Act.

1367. Namely, Article 66-41 of the Act provides that

> *"When the Prime Minister finds it necessary and appropriate for the public interest or protection of investors, with regard to the status of Credit Rating Agency's business operations, he/she may order said Credit Rating Agency to change its business methods or take other necessary measures for improving the status of business operations, within the limit necessary".*

1368. The process leading the issuance of a business improvement order (relating for instance to the reinforcement of the corporate governance structure) comes primarily from the SESC, which submits the report of its inspection to the JFSA's Securities Business Division. The JFSA's Securities Business Division normally after this the JFSA may decide to make a proposal for the issuance of a business improvement order to the Commissioner of the JFSA.

1369. The credit rating agency is required to implement the measures for improving the status of its business operation within the timeframe set out in the order. Afterwards, it is inspected/monitored to ascertain that the time schedule has been adhered to.

1370. CESR understands following additional clarification on this point from the staff of the JFSA that, although a violation of the duty of good faith or of the requirements concerning the operational controls systems, the prohibited acts and the rating policy – set out respectively by Articles 66-32, 66-33, 66-35 and 66-36 of the Act - does not result per se in the application of a sanction, a breach of any of such Articles may result in an order to improve business operation.

1371. If a credit rating agency violates such order to improve business operation, the sanctions discussed in paragraph **1389** letter **b)** below may also apply.

1372. The Commissioner of the JFSA also has the authority to order a credit rating agency to dismiss an officer under Article 66-42(2)[194] of the Act, including in the following cases:

a) Where the credit rating agency has infringed the relevant laws and regulation,
b) When there are facts that undermine the investors' interest with regard to the operations of credit rating business; or
c) When a wrongful act or extremely unjust act has been conducted with regard to credit rating business, and when the circumstances are especially serious.

194 According to Article 66-42(2) of the Act, "A Prime Minister may, when an Officer(s) of a Credit Rating Agency has come to fall under any of sub-items (a) to (g) inclusive of Article 29-4, paragraph (1), item (ii), is found to have already fallen under any of sub-items (a) to (g) inclusive of that item at the time of the registration under Article 66-27, or has come to fall under any of the items (iv) to (vi) inclusive of the preceding paragraph, order said Credit Rating Agency to dismiss such Officer(s)." Article 29-4(1)(ii)(a) to (g) refers to situations pertaining to a juridical person's officers or employees specified by a Cabinet Order and include punishment by imprisonment, fines or severe punishment, commencement of a bankruptcy, withdrawal of registrations, dismissal or removal from the office.

(ix) Power to issue public notices where a credit rating agency is in breach of its obligations

1373. According to Article 66-43 of the Act, the Commissioner of the JFSA must give notice to the public of the fact that it has withdrawn the registration of a credit rating agency, or suspended its business in whole or in part.

1374. Other than in the cases of Article 66-43 of the Act, it is possible that the JFSA calls public attention to the credit rating agency's breach of legal obligations, by announcing it on its website or by other means.

1375. In addition, the application of financial penalties is in the public domain[195]. Where a financial penalty is imposed on a juridical person, the name of the juridical person is disclosed.

(x) Power to refer matters for criminal prosecution to the relevant national judicial authority

1376. The criminal sanctions described below are applied by application to the judicial authority.

1377. In addition to the above list of powers that the JFSA has and the measures that it can take, as explained in paragraph **215** above when assessing equivalence CESR also has to assess whether or not the requirement of Article 23.3 of the EU Regulation that sets out the list of those[196] in addition to the credit rating agency that the authority needs to be able to exercise its powers in respect of is met.

1378. CESR considers that those against whom the JFSA's powers can be exercised are broad enough (even if not identical) to enable the requirements of Article 23.3 of the EU Regulation to be met, and is therefore able to consider the supervision that can be exercised by the JFSA as "effective".

Sanctions

1379. As explained in paragraph **219** above, in assessing equivalence, CESR expects the third country framework to have legal provisions setting out the penalties that can be imposed for breaches of the relevant requirements.

1380. In Japan, the penalties concerning the violation of the provisions on credit rating agencies are incorporated in several Articles of the Act.

A. Penal sanctions

(i) Fine and/or imprisonment of the offender and additional fine on the credit rating agency

1381. As discussed in paragraphs **1383** to **1385** below, the violations of certain rules of the Act pertaining to credit rating agencies can be sanctioned by application of a fine or by imprisonment with work (i.e. imprisonment with servitude) on the offender, or by both a fine and imprisonment with work.

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195 In the Constitution of Japan, the Article 37 stipulates that in all criminal cases, the accused shall enjoy the right to a speedy and public trial by an impartial tribunal. Further, Article 82 stipulates that trials shall be conducted and judgment declared publicly.
When it comes to dispositions taken by administrative agencies, in the Article 12 of the Administrative Procedure Act of Japan, it is stipulated that the administrative agencies shall endeavour to establish disposition standards, and to make such standards available to the public. In the Principles of Financial Supervision and Guidelines of Actions for Supervisory Department Employees (Code of Conduct) established by the JFSA, it is stipulated that the basis and the contents of adverse dispositions shall be basically published.

196 These are: persons involved in credit rating activities, rated entities and related third parties, third parties to whom the credit rating agencies have outsourced certain functions or activities, and persons otherwise related or connected to the credit rating agency or credit rating activities.

1382. Reference is made to the following sanctions:

a) Imprisonment with work for no more than 3 years and/or a fine up to 3 million yen in case where a person:

(i) has obtained registration as credit rating agency by wrongful means, or

(ii) has made other persons to conduct credit rating business in violation of the prohibition of name lending[197];

b) Imprisonment with work for no more than 2 years and/or a fine up to 3 million yen where a representative person, agent, employee or other worker of a credit rating agency has acted in violation of an order to suspend all or part of the business of a credit rating agency (as discussed in paragraphs **1358** to **1362** above)[198];

c) Imprisonment with work for no more than 1 year and/or a fine up to 3 million yen where a person:

(i) has entered a fake statement or record into written application for registration as a credit rating agency or documents to be attached thereto or electromagnetic records[199];

(ii) has failed to prepare or preserve the prescribed documents related to the credit rating business or has prepared false documents[200];

(iii) has failed to submit the prescribed business reports or has submitted business reports containing fake statements[201];

(iv) has failed to make explanatory documents available for public inspection or has provided explanatory documents containing false statements for public inspection, or has failed to make the prescribed publication or has made a false publication[202];

(v) has failed to make a public notice about its intention to discontinue business[203] or has made a false public notice[204];

(vi) has failed to make a notification to the JFSA in the case referred to in the previous bullet (v) or in the case of discontinuance of business following a merger, a decision of commencement of a bankruptcy proceeding or other grounds, or has made a false notification to the JFSA[205];

(vii) has failed to make a report or submit materials upon request or has made a false report or submitted false materials (as discussed in paragraphs **1341** to **1344** above)[206];

(viii) has refused, hindered, or avoided inspections (as discussed in paragraphs **1345** to **1350** above)[207].

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197 Article 198(ii) and 198(iii) of the Act relating, respectively, to violations of Article 66-27 and 66-34 of the Act.
198 Article 198-5(ii) of the Act relating to violations of Article 66-42(1) of the Act.
199 Article 198-6(i) of the Act relating to violations of Article 66-28 of the Act.
200 Article 198-6(iii) of the Act relating to violations of Article 66-37 of the Act.
201 Article 198-6(iv) of the Act relating to violations of Article 66-38 of the Act.
202 Article 198-6(vi-ii) of the Act relating to violations of Article 66-39 of the Act.
203 By applying for the deletion of registration, abolishing its credit rating business, implementing a merger, dissolving on grounds other than a merger, commencing a bankruptcy proceeding or having all its business succeeded by way of a split or transfer of all its business.
204 Article 198-6(ix) of the Act relating to violations of Article 66-40(3) of the Act.
205 Article 198-6(viii) of the Act relating to violations of Article 66-40(1) and Article 66-40(4) of the Act.
206 Article 198-6(x) of the Act relating to violations of Article 66-45(1) of the Act.
207 Article 198-6(xi) of the Act relating to violations of Article 66-45(1) of the Act.

1383. In the cases described above, a system of "dual liability" applies, for both the credit rating agency and its employees.

1384. Article 207 of the Act provides that, where the representative person of a credit rating agency or an agent, employee, or other worker of a credit rating agency has, with regard to the business or property of the credit rating agency, violated the relevant provisions of the Act, not only shall the offender be punished, but also the said credit rating agency shall be punished by a fine.

1385. Namely, the credit rating agency can be sanctioned by application of:

a) a fine up to 300 million yen, in the cases described in paragraph **1382** letter **b)** above;

b) a fine up to 200 million yen, in the cases described in paragraph **1382**, letter **c)**, items (i) to (iv), (vii) and (viii);

c) a fine up to 3 million yen in the cases described:

i. in paragraph **1382** letter **a)**;
ii. in paragraph **1382** letter **c)**, items (v) and (vi)[208].

(ii) Fine on the offender (no imprisonment, but additional fine on the credit rating agency)

1386. In the cases discussed in paragraph **1387** below, the violations can be sanctioned only by application of a fine up to 300,000 yen on the offender (not imprisonment with work).

1387. Reference is made to the cases where a person:

a) has failed to make a notification of changes of certain information included in the registration form, including changes to the contents and methods of the credit rating business[209];

b) has failed as investigating body to enter or record matters with regard to electronic public notice investigations in the investigation record book or entered or recorded a false statement, or failed to preserve the investigation record book (limited to the case of a foreign credit rating agency that gives an electronic public notice of its intention to apply for the deletion of registration or to implement other transactions leading to the termination of its business)[210].

1388. In these cases, pursuant to Article 207 of the Act, an additional fine up to 300,000 yen will be imposed on the credit rating agency.

B. Non-penal sanctions

1389. In addition to the above, the following non-penal fine can be applied:

a) Limited to the case of a foreign credit rating agency that gives an electronic public notice of its intention to apply for the deletion of registration or to implement other transactions leading to the termination of its business, a non-penal fine up to 1 million yen where a person:

i. has failed to request investigation on the availability of information included in the electronic public notice by an investigating body, under Article 941 of the Companies

208 Article 207 (1)(vi) of the Act.
209 Article 205-2-3(i) of the Act relating to violations of Article 66-31(1) or Article 66-31(3) of the Act.
210 Article 205-2-3(vi) of the Act relating to violations of Article 66-40(6) of the Act. Article 955(1) of the Companies Act, as referred to by Article 66-40(6) of the Act, requires the investigating body that carries out an investigation on an electronic public notice to keep and preserve certain investigation records.

Act as applied mutatis mutandis to Article 66-40(6) of the Act[211];

ii. has failed as investigating body to make a report or has made a false report on an electronic public notice investigation in violation of Article 946(3) of the Companies Act as applied mutatis mutandis pursuant to Article 66-40(6) of the Act[212];

iii. has refused, without justifiable grounds, requests by an interested party to the investigating body to inspect or copy financial statements or obtain copies of the investigation records according to respectively Article 951(2) or Article 955(2) of the Companies Act as applied mutatis mutandis pursuant to Article 66-40(6) of the Act[213].

b) A non-penal fine up to 300,000 yen where an officer of a credit rating agency or a representative person in Japan of a credit rating agency which is a foreign juridical person has violated an order to improve business operation (as discussed in paragraphs **1366** to **1371**)[214]above.

c) A non-penal fine up to 100,000 yen in case of failure to pay a reasonable amount of remuneration to the acting representative person in Japan appointed by the JFSA in the case of a vacancy in the office of a credit rating agency which is a foreign juridical person[215].

Violations of the broker-dealers' obligation regarding financial instruments issued by entities that are not registered as credit rating agencies with the JFSA

1390. The following paragraphs describe the measures and sanctions available to the JFSA in case of violation of the obligation discussed in paragraphs **260** to **268** above - imposed on financial instruments business operators with regard to transactions in financial instruments rated by an entity that is not registered as a credit rating agency with the JFSA.

1391. When it is deemed appropriate for the public interest or for protection of investors, the Commissioner of the JFSA may order a financial instruments business operator to change the methods of business, or take other necessary measures for improving its business operation or the status of its property, within the time limit necessary[216].

1392. The Commissioner of the JFSA may also withdraw the authorisation of a financial instruments business operator, or order a suspension of all or part of its business for a period no longer than 6 months[217].

211 Article 207-4(i) of the Act relating to violations of Article 941 of the Companies Act, as applied mutatis mutandis to Article 66-40(6) of the Act. Article 941 of the Companies Act imposes a company that intends to give a public notice by way of electronic public notice to request a person registered with the Minister of Justice to carry out an investigation as to whether the information contained in such public notice is being made available to the general public during the public notice period.

212 Article 207-4(ii) of the Act relating to violations of Article 946(3) of the Companies Act, as applied mutatis mutandis to Article 66-40(6) of the Act.

213 Article 207-4(iii) of the Act relating to violations of the items of Article 951(2) or Article 955(2) of the Companies Act which are applied mutatis mutandis pursuant to Article 66-40(6) of the Act.

214 Article 208(viii) of the Act relating to violations of Article 66-41 of the Act.

215 Article 209(vii) of the Act relating to violations of Article 66-46(2) of the Act.

216 Article 51 of the Act.

217 Article 52(1)(vi) of the Act.

Box 71

EFFECTIVE SUPERVISION AND ENFORCEMENT

1393. **For the purposes of carrying out its oversight tasks, the JFSA is endowed with a wide and comprehensive range of powers and is able to take a number of measures against credit rating agencies for breach of the provisions of the Act concerning credit rating agencies.**

1394. **CESR considers these powers and measures are equivalent to those that must be available to EU competent authorities under the EU Regulation.**

1395. **CESR considers that the supervision that the JFSA is legally empowered to carry out can be effective.**

1396. **CESR notes that inspections of credit rating agencies are carried out by the Securities and Exchange Surveillance Commission which is a separate commission under the JFSA with independent decision making powers but whose budget and staffing are determined by the Commissioner of the JFSA.**

1397. **Sanctions that are applicable in case of infringement of the legal provisions concerning credit rating agencies are set out by law.**

1398. **CESR points out following further clarification of this issue from the staff of the JFSA that, although a violation of the duty of good faith or the requirements concerning the operational control systems, the Prohibited Acts and the rating policy do not result per se in the application of a sanction, a breach of any such requirement may result in an order to suspend in all or in part the credit rating agencies business, or in an order to improve the business operations of the credit rating agency by the Commissioner of the JFSA or even in the withdrawal of the registration. If a credit rating agency violates the aforesaid orders, sanctions may also apply.**

Section V. Summary of minor differences between the Japanese legal and supervisory framework for credit rating agencies and the EU Regulation.

1399. This section of the advice sets out CESR's global assessment of the equivalence between the Japanese legal and supervisory framework for credit rating agencies and the EU regime and summaries the minor differences as discussed in Section IV of this advice.

Box 72

GLOBAL ASSESSMENT

1400. **CESR concludes that overall the Japanese legal and supervisory framework is equivalent to the EU regulatory regime for credit rating agencies in terms of what CESR considers to be the overall objective of:**

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the credit rating agencies integrity, transparency, good governance and reliability of the credit rating activities".

1401. **CESR points out that it considers that the Japanese legal and supervisory framework for credit rating agencies is be very comprehensive and in many respects similar to that of the EU Regulation.**

1402. **There are no areas where the Japanese requirements do not meet the objectives of the EU requirements, there are no shortcomings, and as such CESR has no recommendations to make in respect of the regime as a whole for the purposes of an equivalence determination by the European Commission.**

1403. **CESR points out that its conclusion is based on a review of Japanese Financial Services Agency's unofficial published translations of the relevant parts of the legal texts in relation to credit rating agencies, namely (i) the Financial Instruments and Exchange Act (Act No 25 of 1948) related to the regulation of Credit Rating Agencies, (ii) the Cabinet Office Ordinance on Financial Instruments etc related to Regulation on Credit Rating Agencies (Ordinance No 52 of 2007), (iii) the Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act related to Regulation on Credit Rating Agencies (Ordinance No 14 of 1993), and (iv) the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc (Supplement) Guidelines for Supervision of Credit Rating Agencies, as well as on explanations of relevant provisions provided by the staff of the JFSA.**

Areas of minor differences:

1404. For the purposes of completeness, CESR sets out below those requirements where there are some minor differences between the EU and the Japanese requirements which it considers are noteworthy in this Section of the advice, but points out that none of these differences has any impact on the ability of the Japanese requirements to meet any of the objectives of the EU requirements.

1405. These differences are set out in respect of each of the areas of the EU Regulation, which as explained in detail in this advice, for the purposes of assessing equivalence, CESR has divided into the following seven areas:

a) The scope of the regulatory and supervisory framework
b) Corporate governance
c) Conflicts of interest management
d) Organisational requirements
e) Quality of methodologies and quality of ratings
f) Disclosure
g) Effective supervision and enforcement

a) The scope of the regulatory and supervisory framework

1406. In respect of this area of the EU Regulation, for completeness CESR sets out the following three minor differences:

a) the scope of credit rating agencies that need to be registered;
b) the treatment of groups; and
c) the exemptions that may be applied:

a) Registration

1407. Registration is only required for those credit rating agencies that want to attain registered status in order to enable their credit ratings to be used for regulatory purposes as the Japanese legal and supervisory framework for credit rating agencies operates a two tier system. For further information on this point please see paragraphs **421** to **430** above.

1408. Additional obligations are imposed on broker dealers vis-à-vis the explanations they have to provide to their clients when they solicit transactions on financial instruments that have been rated by entities that are not registered as credit rating agencies with the JFSA. For further information on this point please see paragraphs **260** to **268** above.

b) Group structures

1409. The regime has a pragmatic approach to group structures, allowing the requirements concerning (a) operational control systems, (b) preparation and announcement of the rating policy, (c) record-keeping and (d) preparation and disclosure of explanatory documents, to be jointly met by credit rating agencies registered with the JFSA that perform business as a group. For further information on this point please see paragraphs **431** to **462** above.

c) Exemptions

1410. The Japanese legal and supervisory framework allows for exemptions as follows:

- certain limited exemptions that can be granted to all credit rating agencies (pertaining to rotation rule and supervisory committee)[218];
- certain exemptions that may be granted only to foreign credit rating agencies (internal control systems, measures for preventing conflicts of interests, measures for the examination of the validity of the rating related to a structured finance products).

1411. In both cases, the exemption is subject to the Commissioner of the JFSA's approval, involving the assessment of whether or not a number of conditions are met. For further information on this point please see paragraphs **463** to **480** above.

b) Corporate governance

1412. In respect of the corporate governance area of the EU Regulation, CESR points out the one minor difference in respect of the Supervisory Committee.

Supervisory Committee

1413. There is no specific provision that allocates the responsibility of the specific monitoring tasks to only the independent members of the Supervisory Committee. All members of the Supervisory Committee are responsible for the appropriate establishment of the operational control systems. However, all officers have a duty to execute their business independently. For further information on this point please see paragraphs **526** to **547** above.

c) Conflicts of interest management

1414. In respect of the conflicts of interest management area of the EU Regulation, CESR sets out the four areas of minor difference relating to:

a) Disclosures of the main clients of the credit rating agency;
b) Disclosure of ancillary services in rating reports;
c) Rotation;
d) Prohibition to assume a key management position in a rated entity of related third party.

a) Public disclosure of names of rated entities from which it receives more than 10% of annual revenue

1415. A credit rating agency needs to publicly disclose the names of the rated entities from which it receives more than 10% (instead of 5%) of its annual revenue. In addition, a credit rating agency needs to record information on any rating stakeholder who paid fees to it. For further information on this point please see paragraphs **591** to **597** above.

[218] Subject to different conditions under Articles 306(2)&(3) and 306(6) of the COOFIN.

b) Disclosure of ancillary services in rating reports

1416. There is no requirement for credit rating agencies to disclose in rating reports ancillary services provided for the rated entity or any other related third party. However, there is a disclosure, during the registration phase as well as an on-going basis (in the business report to the JFSA and the explanatory documents made available to the public), on the type and status of the ancillary services performed by the credit rating agency. For further information on this point please see paragraphs **615** to **624** above.

c) Rotation requirement

1417. A rotation requirement is in place, but not in identical terms. Credit rating agencies may choose between 2 options (applying respectively to lead rating analysts and to a third of the members of the rating committee). For further information on this point please see paragraphs **652** to **662** above.

d) Assuming key management positions in a rated entity or related third party

1418. There is not an express prohibition for a former employee of a credit rating agency from assuming a key management position at a rated entity or related third party, but only from initiating an approach to the rating stakeholder. However, the objectives of the EU requirement are achieved through other provisions: a) prohibition to participate in the determination of a credit rating in which a credit analyst has a potential conflict of interest, and b) prohibition to promise the outcome of the rating before its determination. For further information on this point please see paragraphs **713** to **724** above.

d) Organisational requirements

1419. In respect of the organisational requirements area of the EU Regulation, CESR sets out below the three areas of minor difference as follows:

- Independence of the compliance officer;
- Continuity and regularity in the performance of credit rating activities;
- Outsourcing.

Requirement to prohibit the compliance officer from being involved in credit rating activities

1420. There is no explicit requirement to prohibit the compliance officer per se from being involved in credit rating activities, but according to the relevant Japanese provisions the credit rating agencies do have to have processes in place to ensure that the compensation of the compliance officer is not affected by the performance of credit rating business. In addition, the Supervisory Committee is in charge of monitoring the overall compliance of the credit rating agency with its internal policies and procedures and the work and responsibilities of the compliance officer. For further information on this point please see paragraphs **801** to **810** above.

Requirement to ensure continuity and regularity in the performance of credit rating activities

1421. There is no explicit requirement obliging the credit rating agencies to ensure continuity and regularity in the performance of credit rating activities. However, the relevant Japanese requirements make reference to appropriateness and smooth operation of the business, which CESR takes to have the same meaning. In addition, CESR considers that the continuity requirement is met also through making sure that sufficient personnel are allocated to the performance to credit rating activities. For further information on this point please see paragraphs **811** to **819** above.

Outsourcing

1422. Credit rating agencies registered with the JFSA that perform their business as a group, may be allowed to meet jointly the following requirements in the event that a number of conditions are met: (a) operational control systems, (b) preparation and announcement of the rating policy, (c) record-keeping and (d) preparation and disclosure of explanatory documents. The responsibility for compliance with these requirements cannot be outsourced. For further information on this point please see paragraphs **826** to **837** above.

e) Quality of methodologies and quality of ratings

1423. In respect of the quality of methodologies and of ratings area of the EU Regulation, CESR sets out below the nine areas of minor difference as follows:

a) independence of review function;

b) monitoring of methodologies on an ongoing basis and at least annually;

c) use of information from reliable sources in determining a credit rating;

d) informing the rated entity in advance of publication of the credit rating;

e) withdrawal of an existing rating

f) rotation;

g) requirement for methodologies to be continuous and subject to validation based on historical experience;

h) notching; and

i) method of disclosing the likely scope of credit ratings affected by changes to rating methodologies.

a) Independence of review function

1424. There is no express requirement for the review function to be independent from the business lines responsible for credit rating business activities. However, this function is part of the operational control systems aimed at ensuring the performance of credit rating activities from an independent standpoint. For further information on this point please see paragraphs **879** to **895** above.

b) Monitoring of methodologies on an ongoing basis and at least annually

1425. There is no specific requirement for methodologies to be monitored on an ongoing basis and at least annually but a credit rating agency needs to have proper measures to monitor the effectiveness and validity of methodologies. CESR understands following additional clarification on this point from the staff of the JFSA that in order for these measures to be considered properly established, the JFSA has a reasonable expectation that the monitoring is carried out on an-ongoing basis and at least annually. For further information on this point please see paragraphs **896** to **898** above. These measures are expected to monitor also the impact of changes in macroeconomic or financial market conditions on credit rating, irrespective of the lack of a specific requirement. For further information on this point please see paragraphs **947** to **949** above.

c) Use of information from reliable sources in determining a credit rating

1426. There is no specific requirement to use information from reliable sources in determining a credit rating, but CESR understands following additional clarification on this point from the staff of the JFSA that it is implied in the requirement to have measures to ensure that the information used in determining a credit rating is of sufficient quality. For further information on this point please see paragraphs **940** to **946** above.

d) Informing the rated entity in advance of publication of the credit rating

1427. There is a requirement to have measures to enable to check factual errors in the rating before it is provided or made available to the public, but there is no explicit requirement for the rated entity to be informed at least 12 hours before publication of the credit rating. The determination of the length of the period is left to the credit rating agency, for further information on this point please see paragraphs **950** to **957** above.

e) Withdrawal of an existing rating

1428. There is no express requirement to withdraw an existing rating if the credit rating agency does not have sufficient quality information, but the objective is met since there is an express obligation to refrain to issue a rating in this circumstance and to update ratings on an ongoing basis. For further information on this point please see paragraphs **958** to **963** above.

f) Rotation

1429. The rotation requirement is not identical, for further information on this point please see paragraphs **964** to **973 above**.

g) Requirement for methodologies to be continuous and subject to validation based on historical experience

1430. There is no specific requirement for methodologies to be continuous and subject validation based on historical experience including back testing, but there is a requirement for methodologies to be rigorous and systematic and CESR understands following additional clarification on this point from the staff of the JFSA that this requirement covers also the issue of continuity and back tasting. For further information on this point please see paragraphs **983** to **987** above.

h) Notching

1431. There is no express prohibition to refuse to issue a credit rating on an entity because a position of an entity has not been rated by the credit rating agency, but CESR understands following clarification of this point from the staff of the JFSA that this expected to be covered by the prohibition to refuse to issue a credit rating on a structured product because the products or its underlying assets were rated by another credit rating agency. For further information on this point please see paragraphs **998** to **1000** above.

i) Method of disclosing the likely scope of credit ratings affected by changes to rating methodologies

1432. There is no requirement to disclose the likely scope of credit ratings to be affected by changes to the rating methodologies by using the same means of communication as was used for the distribution of the affected credit ratings. However, the policy on how to communicate with market participants is required to be disclosed, for further information on this point please see paragraphs **991** to **996** above.

f) Disclosure

Disclosure about credit ratings

1433. In respect of the disclosure requirements about credit ratings area of the EU Regulation, CESR sets out below the four areas of minor difference as follows:

a) recording and disclosure of job titles;

b) information about amendments following disclosure of the credit rating to the rated entity; and

c) risk warning disclosure; and

d) disclosure regarding the outcome of the assessment of due diligence.

a) Recording and disclosure of job titles

1434. There is no explicit requirement for the job titles of the lead rating analysts and the person primarily responsible for approving the rating to be recorded or publicly disclosed; however, this information will be available to the JFSA upon request For further information on this point please see paragraphs **1092** to **1098** above.

b) Information about amendments following disclosure of the credit rating was to the rated entity

1435. There is no requirement to disclose information on whether a credit rating was amended following disclosure to the rated entity. For further information on this point please see paragraphs **1099** to **1109** above.

c) Risk warning disclosure

1436. The risk warning disclosure requirements cover following clarification of this issue from the staff of the JFSA information on the characteristics of the fluctuation of the credit rating and its limita-

tion, and for structured products, analysis of loss, cash flow and sensitivity. For further information on this point please see paragraphs **1118** to **1122** above.

d) Disclosure regarding the outcome of the assessment of due diligence

1437. There is no requirement to disclose how the outcome of assessments of the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments has impacted the credit rating. For further information on this point please see paragraphs **1147** to **1154** above.

Disclosure about credit rating agencies

1438. In respect of the disclosure requirements about the credit rating agencies area of the EU Regulation, CESR sets out below the three areas of minor difference as follows

a) disclosure in relation to the list of main clients;

b) disclosure of historical default rates; and

c) publication of statistics on methodologies or model appraisals.

a) Disclosure in relation to the list of main clients

1439. There is no requirement to disclose a list of the clients whose contribution to the growth rate in the generation of revenue of the credit rating agency in the previous financial year exceeded the growth rate in the total revenues of the credit rating agency in that year by a factor of more than 1,5 times. For further information on this point please see paragraphs **1227** to **1231** above.

b) Disclosure of historical default rates

1440. There is no requirement for the disclosure of historical default rates of rating categories to be differentiated based on geographical areas. Moreover, the frequency of publication is not identical. For further information on this point please see paragraphs **1232** to **1236** above.

c) publication of statistics on methodologies or model appraisals

1441. There is no requirement to publish statistics on methodologies or model appraisals. However, CESR understands following additional clarification on this point from the staff of the JFSA that the review needs to be conducted on an on-going basis, and every time material changes are made or to be made, the credit rating agency needs to publish the material change without delay. For further information on this point please see paragraphs **1257** to **1265** above.

g) Effective Supervision and enforcement

1442. In respect of the effective supervision and enforcement area of the EU Regulation, CESR sets out below the one area of minor difference.

1443. Violations of the duty of good faith or the requirements concerning the operational control systems, the Prohibited Acts and the rating policy do not result per se in the application of a sanction. However following additional clarification on this point from the staff of the JFSA CESR understands that a breach of any such requirement may result in an order to suspend in all or in part the credit

rating agency's business, or in an order to improve the business operations of the credit rating agency by the Commissioner of the JFSA or even in the withdrawal of the registration. If a credit rating agency violates the aforesaid orders, sanctions may also apply. For further information on this point please see paragraphs **1328** to **1392** above.

Section VI. Early warning system

1444. In accordance with the mandate, CESR has been asked to advise of an early warning mechanism in relation to identifying significant changes to the Japanese regime that may in the future necessitate a change in the decision regarding equivalence that is made.

1445. CESR points out that it has included non negotiable provisions in the coordination arrangements that it is currently in the process of negotiating whereby the JFSA would be sharing information on a regular basis regarding any such changes to the Japanese legal and supervisory framework.

1446. In addition, if the JFSA begin their equivalence evaluation of the EU Regulation, clearly this is something that will require engagement with the JFSA.

Box 73

CHANGES TO THE JAPANESE LEGAL AND REGULATORY FRAMEWORK

1447. CESR proposes upon the receipt of any information of such a change, to evaluate whether or not it considers such a change to be of material significance in terms of impacting on important provisions, and in the event that this was the case, advising the Commission accordingly.

Annex 1

EUROPEAN COMMISSION

Internal Market and Services DG

The Director General

Brussels, 12 JUIN 2009 -129406
MARKT G3/MTF/mg Ares (2009)

Mr Eddy Wymeersch
Chairman
Committee of European Securities
Regulators (CESR)
11-13 avenue de Friedland
F – 75008 Paris

Subject: **Request for CESR technical advice on the equivalence between certain third country legal and supervisory frameworks and the EU Regulatory regime for credit rating agencies**

Dear Eddy,

In the context of the Regulation (EC) on Credit Rating Agencies ("CRA Regulation") approved by the European Parliament on 23 April 2009 and by the Council, I enclose a mandate to CESR for advice on the equivalence between regulatory (legal and supervisory) frameworks of third countries applicable to the activity of credit rating agencies and the regulatory framework for credit rating agencies introduced in the Community by the CRA Regulation. The mandate consists of two parts:

(i) technical assistance for the assessment of the regulatory frameworks of the USA, Canada and Japan" and;

(ii) a fact finding exercise to establish whether other additional jurisdictions should be assessed.

The issue of the third country regime was the most debated point during the negotiation of the CRA Regulation. The regime agreed upon should work effectively. As you know, in order to favour competition from smaller players that are not systemically important for EU markets – and in a way avoid that third country firms provide ratings that are used in the EU without respecting the EU framework – a 'certification system' has been conceived based on an equivalence assessment of both the legal framework as well as the supervisory and enforcement system of a third country. As a key precondition for the certification mechanism, the Commission will have to recognise that the third country's regulatory and supervisory regime for credit rating agencies is equivalent to the one in the EU. Third country jurisdictions currently in the process of developing their regulatory frameworks for credit rating agencies shall ensure that rules applicable and supervisory capacity match EU standards.

On the contrary, systemically important credit rating agencies will always need to go through an 'endorsement mechanism' of the credit rating by the affiliated entity which is established in the EU. This is necessary in order to attach responsibility to a player within the EU and also allow for efficient supervision by EU regulators.

Concerning the equivalence assessment, following G-20 recommendations agreed last April all G-20 members should put in place a legal framework and oversight regime for credit rating agencies. Nevertheless, we are conscious that at this stage it would be impossible – and not necessarily useful – to assess the regulatory framework of all these countries. In this context, technical assistance by CESR is requested for the priority equivalence assessment of United States, Canada and Japan, since, according to preliminary information we have received, a number of small credit rating agencies from these countries might be interested in providing credit ratings in the EU. In addition, in order to preserve the continuity of the use of credit ratings within the EU and to avoid any unintended disruption in the financial markets, it is necessary to identify whether credit rating agencies from other jurisdictions are already providing credit ratings to EU financial institutions or have the intention to do so in the future. Thus, a fact-finding exercise is necessary to identify other jurisdictions which might need to be assessed.

As the formal adoption of the CRA Regulation is foreseen by the end of September, we anticipate receiving the CESR technical advice by 15 February 2010 in order to allow the formal comitology procedures to be in place at due time before October 2010 (expected date for the mandatory use of credit ratings issued by registered or certified credit rating agencies). The timetable is very tight as the Commission will have to obtain the formal opinion of the European Parliament during the comitology procedure, before adoption of the implementing measures. It is important that both the Commission and CESR cooperate under this very tight timetable in order to avoid any unintended disruption of the financial markets.

DG MARKT services and CESR have a long standing and successful cooperation record in working together in the preparation of implementing legislation for EU legal acts. I am confident that we will all deploy our best efforts for a successful outcome.

Yours sincerely,

Jörgen HOLMQUIST

Enclosure: - Formal mandate to CESR for technical advice

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EUROPEAN COMMISSION

Internal Market and Services DG

FORMAL MANDATE TO CESR FOR TECHNICAL ADVICE ON THE EQUIVALENCE BETWEEN CERTAIN THIRD COUNTRY LEGAL AND SUPERVISORY FRAMEWORKS AND THE EU REGULATORY REGIME FOR CREDIT RATING AGENCIES (CRAs)

The present mandate takes into consideration the agreement on implementing the Lamfalussy recommendations reached with the European Parliament on 5 February 2002. In this agreement, the Commission committed itself to a number of important points, including increasing transparency. For this reason, this request for technical advice will be made available on DG Internal Market and Services' web site once it has been sent to CESR. The European Parliament has also been duly informed.

This mandate focuses on a technical issue which follows from the adoption of Regulation (EC) XX/2009 on Credit Rating Agencies (approved by the European Parliament on 23 April 2009 and by the Council on the same day; formal adoption pending): it relates to the recognition of regulatory (legal and supervisory) frameworks of third countries applicable to the activity of credit rating agencies as being equivalent to the regulatory framework for CRAs introduced in the Community by the afore-mentioned Regulation.

The legal base for future implementing measures is Article 4a(3) of Regulation (EC) XX/2009 (pending formal adoption the reference text is the one approved by the European Parliament on 23rd April 2009: P6_TA-PROV(2009)0279).

1. CONTEXT

1.1. Legal context

Role of the equivalence assessment

The CRA Regulation envisages in Article 4a(3) that the Commission may adopt an equivalence decision in accordance with the adequate comitology procedure (regulatory procedure[1]), stating that the legal and supervisory framework of a third country ensures that credit rating agencies authorised or registered in that third country comply with legally binding requirements which are equivalent to the requirements resulting from this Regulation and which are subject to effective supervision and enforcement in that third country. The CRA Regulation also stipulates that the Commission would, in accordance with the adequate comitology procedure (regulatory procedure with scrutiny[2]), specify

[1] Article 5 and Article 7 of Council Decision 1999/468/EC, OJ L184, 17.07.1999, p.23.

[2] Article 5a(1) to (4) and Article 7 of Council Decision 1999/468/EC as amended by Council Decision 2006/512/EC, OJ L200, 17.07.2006, p.11.

further or amend the criteria for assessing the equivalence in order to take account of developments on financial markets.

A positive equivalence determination will allow qualifying credit rating agencies from that third country to apply for certification in accordance with the conditions and the procedure laid down in Article 4a. Those CRAs, which have been certified by the EU competent authorities, would be able to seek exemptions from specific organisational requirements set out in Section A of Annex I and Article 6(4) and as well as from the requirement of physical presence in the Community. Any reliefs in those respects would be offered by the EU competent authorities on a case-by-case basis.

It should be stressed that a positive outcome of equivalence assessment (and resulting equivalence decision by the Commission) alone does not automatically entitle credit rating agencies from a third country concerned to operate in the European Union without any registration. Pursuant to Article 4a(1) credit rating agencies issuing ratings related to entities established or financial instruments issued in third countries would be able to apply for certification, provided that the following criteria are met in addition to a positive equivalence decision of the Commission:

(a) the credit rating agency is authorised or registered and is subject to supervision in a third country;

(b) the cooperation arrangements between the third country supervisor and the EU competent authorities are operational;

(c) the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.

Only after all of the above conditions are satisfied and the credit rating agency from a third country has been certified, may its ratings be used in the European Union by financial institutions and other persons and may the credit rating agency from a third country be recognised as External Credit Assessment Institution ("ECAI") under Directive 2006/48/EC[3].

This specific registration procedure consisting of the recognition of equivalence of the legal and supervisory framework of a third country and the individual certification assessment of credit rating agencies from that third country is intended to enhance competition in the credit rating business. Therefore, once equivalence of the legal and supervisory framework of a third country is recognized, the credit rating agencies from that third country will have new business opportunities in the European Union.

Elements of the equivalence assessment

According to the CRA Regulation[4], a third-country legal and supervisory framework may be considered equivalent to this Regulation if the third country framework fulfils at least the following conditions:

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[3] OJ L 177, 30.6.2006, p.1 as amended

[4] See Article 4a(3) points (a) to (c) of the second subparagraph.

(a) credit rating agencies in the third country are subject to authorisation or registration and are subject to effective supervision and enforcement on an ongoing basis;

(b) credit rating agencies are subject to legally binding rules which are equivalent to those set out in Articles 5 to 10 and Annex I of this Regulation; and

(c) the third-country regulatory regime prevents interference of supervisory authorities and other public authorities of that country with the content of credit ratings and methodologies.

As stated above, the same Article 4a(3) of the CRA Regulation stipulates that the Commission would specify further or amend the criteria for assessing the equivalence in order to take account of developments on financial markets. Those measures, designed to amend non-essential elements of this Regulation, should be adopted in accordance with the adequate comitology procedure (regulatory procedure with scrutiny[5]).

1.2. Mechanism for assessing the equivalence

The Commission intends to apply, in full agreement with the European Securities Committee, the following mechanism:

– the European Securities Committee will assist the Commission as the regulatory committee under the existing comitology framework (Article 33(2) and (3) of the CRA Regulation);

– CESR should provide a technical advice for the assessment of the equivalence of regulatory (legal and supervisory) frameworks of third countries for CRAs with the regulatory framework introduced by the CRA Regulation.

1.3. Deadline for CESR's technical advice: 15 February 2010

This mandate takes into consideration that CESR needs enough time to prepare its technical advice and that the European Commission needs to formalise the relevant comitology measure while respecting the legal deadlines set within the comitology process. More importantly, it takes into account the fact that 12 months after the entry into force of the Regulation, financial institutions will be allowed to use for regulatory purposes exclusively credit ratings from registered/certified CRAs or ratings endorsed by EU-registered CRAs. For these reasons, the deadline set to CESR to deliver the technical advice is 15 February 2010.

The establishment of the deadline is based on the following timetable. In case the entry into force of the Regulation was delayed due to late publication in the Official Journal of the European Union, deadlines could be further extended if appropriately justified.

[5] Article 5a(1) to (4) and Article 7 of Council Decision 1999/468/EC as amended by Council Decision 2006/512/EC, OJ L200, 17.07.2006, p.11.

Deadline	Action
October 2009 (assumption)	Expected entry into force of the CRA regulation (20 days after publication in the Official Journal of the European Union)
15 February 2010	CESR technical advice
March 2010	Formal Commission draft comitology measure sent to the European Securities Committee and published on the Internet
March – June 2010	Examination of the draft comitology measure in the European Securities Committee
June 2010	Vote in the ESC on the comitology measure
April 2010	CRA regulation becomes applicable in the EU (six months after entry into force of the Regulation)
July 2010	Formal adoption of the comitology measure by the Commission (period for right of oversight by European Parliament taken into account)
October 2010	Financial institutions required to use for regulatory purposes exclusively ratings from registered/certified CRAs or ratings endorsed by EU-registered CRAs (12 months after the entry into force of the Regulation)

2. THE PRINCIPLES THAT CESR SHOULD TAKE ACCOUNT OF

2.1. Nature of the assessment

The CRA Regulation has set up a strict EU legal and supervisory framework which should be preserved by all actors and market participants in order to underpin confidence in the financial markets. Therefore, the assessment to be done by CESR is of a technical nature and should not contain political considerations.

2.2. The working approach

On the working approach, CESR is invited to take account of following principles:

– CESR should provide comprehensive technical analysis on the subject matters described below covered by the delegated powers included in the relevant comitology provision of the CRA Regulation, in the corresponding recitals as well as in the relevant Commission request included in the mandate;

– CESR should address to the Commission any questions they might have concerning the clarification on the text of the CRA Regulation, which they should consider of relevance to the preparation of its technical advice;

– The technical analysis carried out should contain sufficient and detailed explanations for the assessment done, and be presented in an easily understandable language respecting current legal terminology used in the field of securities markets and company law at European level.

2.3. Objectives to be observed in the examination

In giving its advice, CESR should take full account of the following key objectives:

– In the assessment whether credit rating agencies authorised or registered in a third country comply with legally binding requirements which are equivalent to the requirements resulting from the CRA Regulation and whether they are subject to effective supervision and enforcement in that third country, the priority should lie in assuring that users of ratings in the EU would benefit from equivalent protections in terms of CRAs' integrity, transparency, good governance and reliability of the credit rating activities (cf. Article 1 of the CRA Regulation). An indicative description of the areas which should be considered in the assessment, as well as the regulatory principles to be respected by the examined third country regime, has been included in the Table below.

Measures to ensure integrity and independence
– A CRA identifies and eliminates (or manages and discloses) conflicts of interest.
– A CRA ensures that business interest does not impair the independence and accuracy of ratings.
– A CRA does not provide consultancy or advisory services; an exhaustive and limited list of ancillary services, which may be provided by a CRA, is defined in the third country legal framework;
– A CRA refrains from issuing a rating when it has direct or indirect interest in the entity asking for a rating;
– Rating analysts cannot make proposals or recommendations on the design of structured finance products;
– Rating analysts are not involved in the negotiation of the fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control;
– Rating analysts' compensation and performance evaluation is de-linked from the revenue they generate for the CRA;

- A stringent rotation policy is put in place (lead rating analysts to rotate client at least every 4 years);

- A CRA keeps records and audit trails of all its activities;

- A CRA has a compliance function, which operates independently;

- Two independent directors on the CRA's administrative or supervisory board are tasked with monitoring the credit rating policy, effectiveness of the internal quality control system as well as the internal controls and measures established to deal with conflicts of interest.

- Competent authorities do not interfere with the content of ratings or the CRAs methodologies.

Measures relating to ratings' quality and enhancing the transparency of the rating activity

- A CRA discloses to what extent it has examined the quality of information used in the rating process and whether it is satisfied with the quality of information it bases its rating on. It will not be allowed to rate financial instruments if it does not have sufficient quality information to base its ratings on.

- A CRA discloses the models, methodologies and key assumptions on which it bases its ratings.

- A CRA differentiates the ratings of structured products by adding a specific symbol.

- A CRA has a function devoted to the periodical review of methodologies and models (review function).

- A CRA applies consistently the changes in methodologies and models to existing ratings.

- A CRA monitors its ratings and methodologies on an on-going basis and at least annually.

- A CRA has a clear and fair policy in relation to unsolicited ratings, which shall be differentiated as such.

- A CRA collects and provides on a regular basis historical performance data (default and transition studies), in accordance with commonly agreed standards.

- A CRA ensures on an on-going basis general disclosure of key information relating to its activity (i.e. on managing conflicts of interest, ancillary services provided, compensation arrangements for its staff, policy on the publication of credit ratings, etc)

- A CRA makes periodical disclosures (i.e. data on the historical default rates, the 20 largest clients by revenue)

- A CRA makes public an annual transparency report with information on the ownership of the agency, staff allocation, description of the quality control system,

outcome of the internal review of independence compliance, financial information regarding the revenue streams, etc.

– A global and holistic assessment of the regulatory framework in question should be carried out from a technical point of view. It should not be limited to just assessing the third country's commitment to any international convergence initiatives aiming at a single set of regulatory standards, such as the Code of Conduct Fundamentals developed by the International Organisation of Securities Commissions (IOSCO). Moreover, the regulatory framework of the third country must include mandatory requirements for the registered CRAs; voluntary regimes are not to be considered equivalent to the regulatory and supervisory framework introduced by the CRA Regulation. CESR should also examine what type of remedies could be applied in case of discrepancy in some limited areas (e.g. introduction in the third country of a special regime for CRAs established in that third country that intend to apply for certification under the CRA Regulation) as specified in point 3.3. of this mandate.

– The global and holistic technical assessment should be based on the entirety of the third country regulatory framework in force in that country. The assessment should focus on the differences between the regulatory regime established at EU level and the third country framework in question. CESR should evaluate and give its judgement on the material importance of such differences. In doing so it should focus on technical criteria and not take into account any considerations of a political nature.

- The third country regulatory and supervisory framework should enter into force at the latest twelve months after entry into force of the CRA Regulation; otherwise the CRAs registered in that third country should apply for registration in the EU and comply with the requirement of being a legal person established in the Community.

– The assessment of whether CRAs are subject to effective supervision and enforcement in that third country should be made in due consideration of the legal and institutional setting in which the third country supervisory authority operates (including its ability to impose sanctions) as well as of its supervisory programme and operational ability to ensure effective compliance.

- Following CESR's technical advice the Commission will decide on the equivalence or otherwise of the third country jurisdictions and adopt a decision following the procedure under Article 4a(3) of the CRA Regulation.

3. CESR IS INVITED TO PROVIDE TECHNICAL ADVICE BY 15 FEBRUARY 2010

3.1. Scope of the assessment

3.1.1. Priority assessment

It is essential that the smooth functioning of the internal market in financial services is preserved; therefore it is necessary to start the equivalence assessment with those third countries where a significant number of ratings used in the EU are produced. CESR is invited to assess by 15 February 2010 the equivalence of the regulatory regimes of the following jurisdictions:

a) United States of America,

b) Japan and

c) Canada.

Prioritisation of these 3rd country jurisdictions takes into account that:

- some small to medium sized CRAs, established in third countries and specialised in financial instruments issued in third countries and entities established in third countries, have already been recognised as an External Credit Assessment Institution (ECAIs) under the Directive on Capital Requirements (Directive 2006/48/EC on the taking up and pursuit of the business of credit institutions),

- following the G-20 recommendations the third countries in which the CRAs are established have started the appropriate legislative procedures in order to amend their regulatory and supervisory framework for CRAs,

- some small credit rating agencies in certain jurisdictions have shown interest to access the EU market,

- one of the objectives of the CRA Regulation is to create incentives for the emergence of new CRAs in the market.

3.1.2. Additional jurisdictions

CESR should also assess whether, beyond the three countries mentioned in point 3.1.1., other third countries regulatory and supervisory frameworks should be included in the present evaluation. CESR is therefore invited to carry out a fact-finding exercise of the use in the European Union of credit ratings issued by credit rating agencies established in third countries other than the three mentioned in point 3.1.1. which refer to the creditworthiness of entities established in those third countries and/or to financial instruments issued in those third countries.

Should there be a confirmed need to examine the equivalence of the regulatory regimes of other third countries, the European Commission will send a new request to CESR to undertake such examination as well.

3.2. Objective of the assessment

CESR is invited to:

a) undertake a global assessment of a third country regulatory regime in accordance with Point 2.2. first indent of this Mandate;

b) advise on an early warning mechanism in case of significant changes to the third country regulatory framework foreseen after 15 February 2010; and

c) describe the supervisory arrangements provided for in the each of the above mentioned jurisdictions which ensure that the regulatory framework applicable to CRAs registered/authorised there is respected.

3.3. Negative outcome of the equivalence assessment

In case where CESR's advice to the Commission would be that there is no equivalence of a third country regulatory regime, CESR is invited to identify clearly those areas where significant discrepancies exist. It is also invited to suggest any solutions which could be considered by the Commission to overcome such discrepancies. Such solutions could be sought from that third country in the context of expected bilateral discussions between the Commission and the third country authorities concerned in order to reach a positive outcome of the equivalence assessment.

Annex 2

16 July 2009
Ref.: CESR/09-719

Assessing the equivalence of CRA regulatory frameworks

1. Introduction

This questionnaire is part of the European Union's legal preparations for establishing a regulatory framework to register and supervise credit rating agencies whose ratings are used for regulatory purposes within the European Union (EU). The new CRA Regulation, due to enter into force approximately on or around the beginning of October 2009, introduces a common regulatory approach in order to enhance the integrity, transparency, responsibility, good governance, and reliability of credit rating activities, contributing to the quality of credit ratings issued in the EU. The regulation lays down the conditions for the issuance of credit ratings and rules on the organisation and conduct of credit rating agencies to promote their independence and avoidance of conflicts of interest.

Article 4a (3) of the CRA Regulation sets out that the EU-Commission may adopt an equivalence decision, stating that the legal and supervisory framework of a third country ensures that credit rating agencies authorised or registered in that third country comply with legally binding requirements which are equivalent to the requirements resulting from this Regulation and which are subject to effective supervision and enforcement in that third country.

A positive equivalence determination by the EU-Commission will allow qualifying credit rating agencies from that third country to apply to CESR for certification in accordance with the conditions and the procedure laid down in Article 4a. Those CRAs, which then become certified by the EU competent authorities, would be able to seek exemptions from specific organisational requirements set out in Section A of Annex I and Article 6 (4) as well as from the requirement of physical presence in the European Union. Any reliefs in those respects would be offered by the EU competent authorities on a case-by-case basis.

CESR was mandated by the EU-Commission to provide it with technical advice in order for it to be able to assess the equivalence of third countries regulatory (legal and supervisory) frameworks for CRAs with the EU regulatory framework which will be introduced by the CRA Regulation.

CESR recognises that your time is at a premium, but points out that your answers to this questionnaire will be the first step in establishing whether or not credit rating agencies from your jurisdiction will be able to operate in the European Union following the implementation of the Regulation. As such, your answers are very important and are are essential in building an accurate picture of the regulatory framework a credit rating agency faces when operating in your jurisdiction.

CESR is aware of the fact that some of the third country regimes that is going to assess will not have been fully adopted by the time it issues its advice. Therefore, that advice will have to be updated as the implementation schedule develops in those countries.

With respect to assessing the equivalence of third country regulatory frameworks and providing advise to the Commission, CESR is running to an extremely tight time schedule, and as such invites you to complete the survey before **15th September 2009**.

All the information you provide will be treated in the strictest confidence

When you have completed the questionnaire please return it via e-mail to rgarcia@cesr.eu and jruiz@cnmv.es. If you have any queries or if you would like further information about this survey please do not hesitate to contact either Javier Ruiz (jruiz@cnmv.es), Raquel García (rgarcia@cesr.eu) or Jörg Schmidt-Ebeling (Joerg.Schmidt-Ebeling@bafin.de).

Instructions to fill in the questionnaire

In order to use this document as a form –and therefore be able to tick on the boxes and fill in the grey areas you need to follow these steps:

- In the bar on top of the screen, click on ***tools***
- Then click on ***protect document***
- Then a new menu pops up on the right side of the screen. Go there and on the second item ***editing restrictions*** tick the box ***allow only this type of editing in the document***
- Scrolls down the menu displayed below and choose ***filling in forms***
- Now go to the third item ***start enforcement*** and click on the box ***Yes, start enforcing protection***
- Then a new window pops up: ***start enforcing protection***. Just click on ***accept*** (no need for password)
- Now you should be able to fill in the document

2. Definitions

The following definitions are taken from Article 3 of the new EU Regulation to facilitate a common understanding of what CESR means when using certain terms throughout this questionnaire:

"credit rating" means an opinion regarding the creditworthiness of an entity, a debt or financial obligation, debt security, preferred share or other financial instrument, or of an issuer of such a financial instrument, issued using an established and defined ranking system of rating categories;

"credit rating agency" means a legal person whose occupation includes the issuance of credit ratings on a professional basis;

"rating analyst" means a person who performs analytical functions that are necessary for the issuance of a credit rating;

"lead rating analyst" means a person with primary responsibility for elaborating a credit rating or for communication with the issuer with respect to a particular credit rating or, generally, with respect to the credit rating of a financial instrument issued by that issuer and, where relevant, for preparing recommendations to the rating committee in relation thereto;

"rating category" means a rating symbol, such as a letter symbol or a numerical symbol which might be accompanied by appending identifying characters, used in a credit rating to provide a relative measure of risk to distinguish the different risk characteristics of the types of rated entities, issuers and financial instruments or other assets.

3. Legislative Framework

3.1 General

1. Is there some form of legally binding regulatory and/or supervisory framework for credit rating agencies in your jurisdiction?

☒ Yes ☐ No

(please provide details of this framework)

Japan adopted a registration system for credit rating agenices (CRAs) in June 2009. Under its registration scheme, legal entities actively engaged in the credit rating business in the Japanese financial markets are requried to register with the Financial Services Agency (FSA), thus becoming CRAs. Entities that use credit ratings in soliciting customers will be required to provide an explanation regarding the credit ratings and the persons who determined them if such credit ratings are not provided by CRAs registered with the FSA.

The framework consists of four pillars, namely, 1) duty of good faith, 2) information disclosure, 3) establishment of operational control systems, and 4) prohibited acts. Firstly, CRAs will be required to conduct operations with fairness and integrity as independent entities. Secondly, they will need to publish rating policies timely and also disclose explanation documents periodically. Thirdly, they will be required to establish operational control systems which ensure quality and fairness in the rating process and the prevention of conflicts of interest. Lastly, they will be prohibited from taking certain acts, such as determining ratings in the cases where they have a close relationship with the issuer of the financial instruments to be rated.

2. What is the definition of a CRA in your jurisdiction?

A "credit rating agency" means a legal person whose occupation includes determining credit ratings and either providing them to someone or making them available to the public on a professional basis and who registers with the FSA under the Financial Instruments and Exchange Act.

Please see the "Definition" and "Registration" sections on page 1 of the exhibit[1]. (Articles 2(35), 2(36) and 66-27 of the Act).

3. Are CRAs in your jurisdiction currently subject to:

- A registration process? ☒ Yes ☐ No
- An authorisation process? ☐ Yes ☒ No
- Effective ongoing supervision and enforcement? ☒ Yes ☐ No

(Please specify and if necessary provide English translations of the relevant laws and regulations)

Regulated under the Financial Instruments and Exchange Act and associated Cabinet Order (Cabinet Order on Financial Instruments and Exchange Act, etc.) and Cabinet Office Ordinances (Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act and Cabinet Office Ordinance on Financial Instruments Business, etc.)

4. Have all relevant laws and regulations already entered into force?

[1] The pages indicated in this document refer to those of the attached exhibit "Regulation for CRAs (Outline of Cabinet Office Ordinances." It should be noted that the exhibit is an unofficial translation of selected provisions of the framework, intended primarily for reference purposes. For accuracy and comprehensiveness, please refer to the original laws and regulations (Original in Japanese: http://www.fsa.go.jp/news/21/20091222-4.html; provisional translation in English: http://www.fsa.go.jp/en/news/2010/20100331-4.html).

☐ Yes ☒ No (if no, please set out the timetable for the adoption of relevant laws and regulations -and base your answers to this questionnaire on the last draft available):

In June 2009, the Japanese Diet passed a legislation (amendment to the Financial Instruments and Exchange Act) which included the introduction of a regulatory framework on CRAs, followed up by the release of associated Cabinet Order and Cabinet Office Ordinances in December, laying out the details of the terms and conditions[2]. The framework requires CRAs to be registered with the FSA, otherwise imposing additional obligatons on broker-dealers for detailed customer explanation upon using the ratings. The framework basically became effective in April 2010, while the provisions imposing additional obligations on broker-dealers when using credit ratings determined by non-registered entities will become effective in October 2010.

5. Do you expect any significant changes to be made to the existing laws and regulations before the 15th February 2010?

☒ No ☐ Yes
(If yes please explain briefly what you anticipate these changes might be!):

The framework has been put in force with all the specifics drawn out; no further changes are anticipated including for the provisions waiting for implementation in October.

6. Do you supervise CRAs also on a group level?

☒ Yes ☐ No

Registration will be required for each individual legal entity. However, considering the global CRA's group-based operation practices, a number of regulatory requirements, such as application for registration, development of operational control systems, and disclosure of rating policies, will be allowed to be met as a whole group.

7. Do you offer exemptions from specific requirements for smaller CRAs?

☐ No ☒ Yes (please explain briefly!):

The rotation rule and the establishment of a supervisory committee will be exempted on a case-by-case basis, considering features including, but not limited to, the size of the CRAs, as described below (Q8).

8. How do you define smaller CRAs that are eligible for such exemptions?

[2] In the regulatory hierarchy, Cabinet Orders issued by the Cabinet is placed in the layer immediately below Laws (Acts), and Ministerial Ordinances, including Cabinet Office Ordinances, issued by ministries and other administrative bodies of the government further below Cabinet Orders.

The eligibility for the exemption is judged not solely by the size of the CRAs, but by taking into account other features of the CRAs as well. The provision states that: considering the number of executives and employees of CRAs and the characteristics, size, complexity and other circumstances of the business in which they are engaged, if they cannot comply with the rotation rule and the establishment of a supervisory committee but can alternatively take appropriate measures to ensure independence, adequacy of business management and financial reporting, compliance with laws and regulations, quality control and prevention of conflicts of interest, they will be exempted from such requirements.

The exemptions for "smaller" CRAs are stipulated in Cabinet Office Ordinance on the Financial Instruments Business, etc., Articles 306(2) and 306(3).

The objective of introducing exemptions for "smaller" CRAs is to promote competition in the credit rating industry through encouraging new entrants, by eliminating excessive regulatory burdens on "smaller" CRAs where specific requirements turn out to be onerous. In this context, in providing exemptions, the FSA will make sure on a case-by-case basis that the "smaller" CRAs ensure their independence and achieve proper governance by relying on alternative measures.

3.2 Measures to ensure integrity and independence

Independence and avoidance of conflicts of interest

9. Are CRAs in your jurisdiction required to identify and eliminate or alternatively manage and disclose conflicts of interest?

☐ No ☒ Yes

Please see Article 306(1)(vii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

Organisational requirements

10. Do you require a CRA to:

a. have an administrative or supervisory board? ☒ Yes ☐ No
b. be organised in a manner that ensures that it's business interest does not impair the independence and accuracy of it's credit rating activities? ☒ Yes ☐ No
c. have at least two independent directors on the CRA's administrative or supervisory board that are tasked with monitoring the credit rating policy, effectiveness of the internal quality control system as well as the internal controls and measures established to deal with conflicts of interest? ☒ Yes ☐ No
d. ensure that the compensation of the independent members of administrative or supervisory board is not linked to the business performance of the credit rating agency and is arranged so as to ensure the independence of their judgement? ☒ Yes ☐ No
e. ensure that the term of office of the independent members of the administrative or supervisory board is for a pre-agreed fixed period and is not renewable? ☐ Yes ☒ No
f. define a term limit for the independent members of the administrative or supervisory board?

☐ Yes ☒ No

Instead of formally requiring the term of office or the term limit for independent members, the independence of independent members of a supervisory committee would be ensured by requiring CRAs to disclose thoughts on their independence in explanatory documents.

g. If you answer yes to the previous question, please advise what the relevant period is:

n/a (period in years)

h. ensure that the majority of members of the administrative or supervisory board, including its independent members have sufficient expertise in financial services? ☒ Yes ☐ No
i. ensure that, if the credit rating agency issues credit ratings of structured finance instruments, at least one independent member and one other member of the board has in-depth knowledge and experience at a senior level of the markets in structured finance instruments?

☐ Yes ☒ No

Considering the CRA's business practices which widely relate to financial services and various industries, independent members of a supervisory committee is required to have expertise in finance, not limited only to structured finance. By taking such criteria, it will be possible to avoid the risk of limiting the pool of individuals eligible for such positions, and in turn expect higher degree of objective monitoring functions to take place.

j. ensure that, in addition to the overall responsibility of the board, the independent members of administrative or supervisory board have the specific task of monitoring:

- the development of the credit rating policy,? ☒ Yes ☐ No
- the development of the methodologies the CRA uses in credit rating activities?

☒ Yes ☐ No

- the effectiveness of the internal quality control system of the CRA in relation to credit rating activities? ☒ Yes ☐ No
- the effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or adequately managed and disclosed? ☒ Yes ☐ No

- the compliance and governance processes including the efficiency of the review function[3]?
  ☒ Yes ☐ No

Please see Article 306(1)(xvii) of the Cabinet Office Ordinance on Financial Instruments Business, etc. for an establishment of a supervisory committee.

k. establish adequate policies and procedures that ensure compliance of its obligations under your regulation? ☒ Yes ☐ No

Please see Article 306(1)(v)(a) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

l. have sound

- administrative and accounting procedures? ☒ Yes ☐ No
- internal control mechanisms designed to secure compliance with decisions and procedures at all levels? ☒ Yes ☐ No
- effective procedures for risk assessment ☒ Yes ☐ No
- effective control and safeguard arrangements for information processing systems? ☒ Yes ☐ No

Please see Article 306(1)(iv) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

m. implement and maintain decision-making procedures and organisational structures, which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities?

☒ Yes ☐ No

The development of operational control systems includes the establishment of decision-making procedures and organizational structure, and the descriptions relating to the operational control systems have to be included in the annexes to the application form.

n. have a permanent and effective compliance function, which operates independently?

☒ Yes ☐ No

Please see Articles 306(1)(v) and 306(1)(xvii) of the Cabinet Office Ordinance on Financial Instruments Business, etc., respectively.

o. establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate or manage and disclose any conflicts of interest? ☒ Yes ☐ No

[3] The function devoted to the periodical review of methodologies, models and key rating assumptions

Please see Article 306(1)(vii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

p. employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities? ☒ Yes ☐ No

Please see Article 306(1)(vi)(a) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

q. have a function (review function) devoted to the periodical review of

- methodologies ☒ Yes ☐ No
- models ☒ Yes ☐ No
- key rating assumptions ☒ Yes ☐ No

A review for the validity and effectiveness of the credit rating determination policies, etc, which include methodologies, models and key rating assumptions, will be required.

Please see Article 306(vi)(d) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

r. monitor and evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with your requirements and take appropriate measures to address any deficiencies? ☒ Yes ☐ No

An implementation of an internal audit will be required for CRAs. This is shown in Article 306 (1)(xvii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

Operational requirements

11. Do you require a CRA to:

a. identify, eliminate or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgments of its rating analysts, employees as well as any other natural persons whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuance of credit ratings and persons approving credit ratings? ☒ Yes ☐ No

Please see Article 306(1)(vii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

b. publicly disclose the names of the rated entities or related third parties from which it receives more than 5 % of its annual revenue? ☐ Yes ☒ No

The answer has been changed to "No", but the disclosure is still required with the threshold being raised to 10%, instead of 5%, of the CRA's annual revenue (net sales).

Please see Article 318(ii)(b)2. of the Cabinet Office Ordinance on Financial Instruments Business, etc. for contents of explanatory documents.

c. not issue a credit rating or, in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected where:
   - the credit rating agency or related persons[4], directly or indirectly owns financial instruments of the rated entity or any related third party or has any other direct or indirect ownership interest in that entity or party other than holdings in diversified collective investment schemes or managed funds including pension funds and life insurance; ☒ Yes ☐ No
   - the credit rating is issued with respect to a rated entity or any related third party directly or indirectly linked to the credit rating agency by control; ☒ Yes ☐ No
   - a related person is a member of the administrative or supervisory boards of the rated entity or any related third party; ☒ Yes ☐ No
   - an analyst who participated in determining a credit rating, or a person who approved a credit rating, has had any relationship with the rated entity or any related third party thereof, which may potentially cause a conflict of interests? ☒ Yes ☐ No

Please see Article 66-35 of the Act and Article 312(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc. for prohibited acts and Article 306(1)(vii) (a)2. of the Cabinet Office Ordinance on Financial Instruments Business, etc. for conflicts of interest.

d. not provide consultancy or advisory services? ☒ Yes ☐ No

Please see Article 66-35(2) of the Act.

e. define what they consider as such services? ☒ Yes ☐ No

Of the advisory services stipulated in Article 66-35(2) of the Act and Article 312 of the Cabinet Office Ordinance on Financial Instruments Business, etc., the acts which will not pose any problems in terms of investor protection are exempted from the definition of prohibited acts in the cabinet office ordinance. Please also see III-2-2 in Guidelines for Supervision of CRAs.

f. ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity and shall disclose in the final ratings reports any ancillary services provided for the rated entity or any related third party? ☒ Yes ☐ No

Please see Article 306(1)(viii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

[4] The persons referred to in the first question of this section (*operational requirements)*

g. ensure that rating analysts or persons that approve ratings cannot make proposals or recommendations on the design of structured finance products about which the CRA is expected to issue a rating?

☒ Yes ☐ No

Please see Article 66-35(2) of the Act for prohibited acts.

h. design its reporting and communication channels so as to ensure independence of related persons from the other activities of the credit rating agency carried out on a commercial basis? ☒ Yes ☐ No

As shown in Articles 306(1)(i) and 306(1)(xi) of the Cabinet Office Ordinance on Financial Instruments Business, etc., measures to prevent conflicts of interest which may arise from other businesses will be required. Such measures should ensure, among others, the independence from other activities of CRAs conducted on a commercial basis.

i. keep adequate records and audit trails of all its rating activities at its premises for at least five years?

☒ Yes ☐ No

Please see Article 66-37 of the Act and Article 315(2) of the Cabinet Office Ordinance on Financial Instruments Business, etc. for books and documents.

12. What other operational requirements ensure that a CRA takes all necessary steps to ensure that the issuance of a credit rating is not affected by any existing or potential conflict of interest or business relationship?

If a CRA has specific business relationships with rating stakeholders, such as those arising from obtaining loans from the said rating stakeholders, or the said rating stakeholders hold share issued by the CRA, it shall ensure that it prevents conflicts of interest arising from such relationships.

Please see Article 306(1)(vii)(a)3. of the Cabinet Office Ordinance on Financial Instruments Business, etc.

Rating analysts, employees and other persons involved in the issuance of credit ratings

13. Are CRAs required to ensure that rating analysts, employees of the credit rating agency as well as any other natural person whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in credit rating activities have appropriate knowledge and experience for the duties assigned?

☒ Yes ☐ No (if yes, please explain how this is verified?)

A CRA shall ensure that it adequately assigns staff with sufficient expertise and skills.

In accompanying documents of an application form, CRAs will be required to describe expertise and recruitment policy for their analysts. In addition to these explanations, measures will be taken to ensure that CRAs' analysts have sufficient knowledge and experiences by requiring them to prevent credit ratings from being determined, in cases where personnel with expertise and skills cannot be sufficiently secured, as shown in Article 306(1)(vi)(a) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

14. Does your regulatory framework require that rating analysts are not involved in the negotiation of the fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control?

☒ Yes ☐ No (please explain briefly!):

A CRA shall ensure that a person who is involved in the determination of credit ratings is prevented from participating in fee negotiations.

Please see Article 306(1)(xi) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

15. Does your regulatory framework contain the following or similar prohibitions regarding rating analysts and other persons (described below) directly involved in credit rating activities?

a. Rating analysts and employees of the CRA as well as any other natural persons whose services are placed at the disposal or under the control of the CRA and who are directly involved in credit rating activities, as well as persons closely associated with shall not buy or sell or engage in any transaction in any financial instrument issued, guaranteed, or otherwise supported by any rated entity within the area of primary analytical responsibility of those persons, other than holdings in diversified collective investment schemes or managed funds including pension funds and life insurance.

☒ Yes ☐ No

Please see Article 306(1)(vii)(a)1. of the Cabinet Office Ordinance on Financial Instruments Business, etc.

b. No person referred to in question 15.a shall participate in or otherwise influence the determination of a credit rating of any particular rated entity if this person:

a) owns financial instruments of the rated entity, other than holdings in diversified collective investment schemes; ☒ Yes ☐ No
b) owns financial instruments of any entity related to a rated entity, the ownership of which may cause or may be generally perceived as causing a conflict of interest, other than holdings in diversified collective investment schemes; ☒ Yes ☐ No

c) has had a recent employment or other business relationship or any other relationship with the rated entity that may cause or may be generally perceived as causing a conflict of interest.

☒ Yes ☐ No

For prohibited acts, please see Articles 66-35(1) and 66-35(3) of the Act. For operational control system, please see Article 306(1)(vii)(a)2. of the Cabinet Office Ordinance on Financial Instruments Business, etc.

As to Q15b. a) and b), in cases where a CRA or its staff in charge of the credit rating holds securities issued by a ratings stakeholder or owns options for derivatives transactions, the CRA as well as its executives and employees will be prohibited from determining credit ratings.

Please see Article 66-35 of the Act and Article 308(1)(iii) of the Cabinet Office Ordinance on Financial Instruments Business, etc. for prohibited acts and close relationships with rating stakeholders.

As to Q15b. c), personal relationships are included in Article 308 of the Cabinet Office Ordinance on Financial Instruments Business, etc., and if there are business relations, measures to prevent conflicts of interest will be required according to Article 306(1)(vii)(a)2. of the Cabinet Office Ordinance on Financial Instruments Business, etc.

c. Are CRAs required to ensure that persons referred to in question 15a of this section:

a) take all reasonable measures to protect property and records in possession of the credit rating agency from fraud, theft or misuse taking into account the nature, scale and complexity of their business and the nature and range of their credit rating activities; ☒ Yes ☐ No
b) do not disclose any information about credit ratings or possible future credit ratings of the credit rating agency, except to the rated entity or its related third party; ☒ Yes ☐ No
c) do not share confidential information entrusted to the credit rating agency with rating analysts and employees of any person directly or indirectly linked to it by control as well as with any other natural persons whose services are placed at the disposal or under the control of any person directly or indirectly linked to it by control and who is directly involved in the credit rating activities; ☒ Yes ☐ No
d) do not use or share confidential information for the purpose of trading financial instruments, or for any other purpose except the conduct of the credit rating activities. ☒ Yes ☐ No

Q15c is understood as relating to a management of confidential information. With the purpose of ensuring the consistency with precedents in Japanese legislation, the rules in Japan are not exactly the same as EU regulation. However, it is reasonable to consider that the same objective and concept for a management of confidential information are

shared. Please see Article 306(1)(xii) of the Cabinet Office Ordinance on Financial Instruments Business, etc. As for Q15c. d), the use of material non-public information obtained during the conduct of business in trading financial instruments will likely constitute an insider trading, which will be penalized in the context of market misconduct.

d. Are those persons referred to in question 15a of this section prohibited from soliciting or accepting money, gifts or favours from anyone with whom the CRA does business?

☒ Yes ☐ No

Please see Article 312(ii) of the Cabinet Office Ordinance on Financial Instruments Business, etc. for prohibited acts.

e. If a person referred to in question 15a of this section considers that any other such person has engaged in a conduct that he or she considers to be illegal, is it required to report such information immediately to the compliance officer without negative consequences for the reporting person?

☒ Yes ☐ No

Please see Article 306(1)(v)(c) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

f. Where a rating analyst terminates his or her employment and joins a rated entity, in the credit rating of which the analyst has been involved, or a financial firm, with which the rating analyst has had dealings as part of his or her duties at the CRA, a is the CRA required to review the relevant work of the analyst preceding his departure? ☒ Yes ☐ No

g. For what period prior to that rating analyst departure (in years or months) is the rating analysts pervious work required to be reviewed?

☒ 2 years ☐ months

Please see Article 306(1)(vii)(a)5. of the Cabinet Office Ordinance on Financial Instruments Business, etc.

h. Are those persons referred to in question 15a of this section prohibited from taking up a key management position with the rated entity or its related third party for a period of at least 6 months since the date of said person assigning that entity or its related third party a credit rating?

☒ Yes ☐ No

Please be noted that while the rule in Japan requires restrictions on seeking positions rather than employment per se, it is expected to serve the same purpose as the EU Regulation.

Please see Article 306(1)(vii)(a)4. of the Cabinet Office Ordinance on Financial Instruments Business, etc.

i. If the period is less than 6 months, please advise what the relevant period is.

Period ☐ (in months)

16. Are CRAs required to establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings?

☐ No ☒ Yes (if yes, please describe the rotation policy):

In order to ensure the executives and employees of a CRA to perform their businesses from an independent standpoint, with fairness and integrity, either of the following options shall be taken; 1) rotation of lead analysts (five years with an interval of two years); or 2) making final decisions on credit ratings at the rating committee, while preventing at least one-third of the total members of the said committee from being successively involved in processes pertaining to the determination of credit ratings of the same rating stakeholder.

- What is the maximum amount of time (in years or months) that each of the following persons are allowed to be involved in the credit rating activities relating to the same rated entity or its related third parties?
  - lead rating analysts 5 years
  - rating analysts n/a
  - persons approving credit ratings n/a

Please see Article 306(1)(ii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

17. Are lead analysts, rating analysts, and persons approving credit ratings required to be involved in credit ratings activities with a rated entity or its related third party for a minimum amount of time?

☒ No ☐ Yes (if yes, please specify the amount of time in months or years)

In general, requiring CRA analysts to gain certain years working experiences could ensure some expertise. On the other hand, a degree of necessary expertise may vary, depending on the industry or financial instruments to be rated, among other factors. Hence, it is considered

not necessarily appropriate to specify the requirement for the minimum years of working experiences for CRA analysts.

18. Does your regulatory framework prohibit a link between a rating analysts' compensation and performance evaluation and the revenue he or she generates for the CRA?

☒ Yes ☐ No

Please see Article 306(1)(x)(b) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

Methodologies, models and key rating assumptions

19. Are CRAs required to disclose the following information?
(please tick the relevant box!)

a. the fact that it is registered in accordance with the relevant laws and regulations

☒ Yes ☐ No

The FSA will disclose the names of CRAs that are registered. As to the disclosure of the history of administrative disposition, please see Article 313(3)(iii)(a) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

b. any actual and potential conflicts of interest ☒ Yes ☐ No

A conflict of interests as to individual credit ratings is prevented by disclosing the names of rating stakeholders and ensuring the transparency. Please see Article 313(3)(iii)(a) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

Identification and prevention of conflicts of interest are publicly disclosed in explanatory documents. Please see Article 318(iii)(e) of the Cabinet Office Ordinance on Financial Instruments Business, etc. Furthermore, an outline of measures to check if there has been a conflict of interest is required to be preserved in books and documents. Please see Article 315(1)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

c. list of its ancillary services ☒ Yes ☐ No

"Other business," including ancillary services, is required to be written in the registration form. As the contents of registration application will be disclosed, ancillary services will also be publicly disclosed.

d. the policy of the CRA concerning the publications of credit ratings and other related communications ☒ Yes ☐ No

Please see Article 313(1) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

e. the general nature of its compensation arrangements ☒ Yes ☐ No

Please see Article 318(iii)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

f. the methodologies, and descriptions of models and key ratings assumptions such as mathematical or correlation assumptions used in its credit rating activities as well as their material changes

☒ Yes ☐ No

Please see Article 313(1) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

g. any material modification to its systems, resources or procedures ☒ Yes ☐ No

A change in procedures of the issuance and determination of credit ratings will be considered a change in rating policies, etc. and disclosed without delay. Please see Article 66-36 of the Act.

Other modifications of governance system, etc. will be reflected in explanatory documents which will be disclosed annually. Please see Article 66-39 of the Act.

h. its code of conduct ☒ Yes ☐ No

Please see Article 318(iii)(n) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

20. Are CRAs required to periodically disclose the following information?
(please tick the relevant box and specify the frequency within which the disclosure is required!)

a. data about the historical default rates of its rating categories (please specify the frequency!)

annually ☒ Yes ☐ No

- distinguishing between the main geographical areas of the issuers and, ☒ Yes ☐ No
- whether the default rates of these categories have changed over time ☒ Yes ☐ No

Statistics for default rates, etc. will be included in "statistics and other information" stipulated in Article 318(ii)(b)3. of the Cabinet Office Ordinance on Financial Instruments Business, etc. Careful attention will be paid so as not to require statistically insignificant data by segmenting categories in an inappropriate manner.

b. a list of the largest 20 clients of the CRA by revenue generated of them (please specify the frequency!): annually ☒ Yes ☐ No

c. a list of the CRA's clients whose contribution to the growth rate in the generation of revenue of the CRA in the previous financial year exceeded the growth rate in the total revenues of the CRA in that year by a factor of more than 1,5 times. (please specify the frequency!):

☐ Yes ☒ No

(client means an entity, its subsidiaries, and associated entities in which the entity has holdings of more than 20%, as well as any other entities in respect of which it has negotiated the structuring of a debt issue on behalf of a client and where a fee was paid, directly or indirectly, to the CRA for the ratings of that debt issue.)

It is questionable whether the information of this kind could serve to prevention of conflicts of interest. For example, the result will be heavily affected by economic climate. Further, in the case of new clients, the growth rate should be infinite.

21. Are CRAs in your jurisdiction required

a. to adopt, implement and enforce adequate measures to ensure that the credit ratings they issue are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies? ☒ Yes ☐ No

Please see Article 313(2) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

b. to adopt all necessary measures so that the information they use in assigning a credit rating is of sufficient quality and from reliable sources? ☒ Yes ☐ No

The development of operational control system will include ensuring the quality of all the information used in ratings. Please see Article 306(1)(vi)(b) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

Furthermore, a draft regulatory regime will promote voluntary efforts for ensuring the information quality by requiring CRAs to disclose the measures taken to ensure the information quality to investors when providing credit ratings. Please see Article 313(3)(iii)(j) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

c. to use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing? ☒ Yes ☐ No

The requirements for credit rating determination policies, etc. include that they shall be rigorous and systematic (Article 313(2)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.) and that they shall include description of the explanation about the validity of the criteria (Article 313(2)(iii)(a) of the Cabinet Office Ordinance on Financial Instruments Business, etc.). As a result, the regulatory regime requires the methodology which should be sustainable to back-testing.

d. not to refuse to issue a credit rating of an entity or a financial instrument because a portion of the entity or the financial instrument had been previously rated by another CRA, where a CRA is using an existing credit rating prepared by another credit rating agency with respect to underlying assets or structured finance instruments? ☒ Yes ☐ No

Please see Article 312(iii) of the Cabinet Office Ordinance on Financial Instruments Business, etc. for prohibited acts.

e. to record all instances where in its credit rating process it departs from existing credit ratings prepared by another CRA with respect to underlying assets or structured finance instruments providing a justification for the differing assessment? ☒ Yes ☐ No

Although a CRA is not required to provide a justification for the differing assessment from another CRA, important records that could be used for a comparison to another CRA's credit ratings, such as information submitted to the rating committee and materials on which the determination of credit ratings is based, shall be preserved in books and documents. Please see Article 315 of the Cabinet Office Ordinance on Financial Instruments Business, etc.

f. to monitor its ratings and methodologies on an on-going basis and at least annually? ☒ Yes ☐ No

g. to establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings?

☒ Yes ☐ No

h. When methodologies, models or key rating assumptions used in credit rating activities are changed are CRAs required:

- to apply the changes in methodologies and models consistently to existing ratings?

☒ Yes ☐ No

- to immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distributions of the affected credit ratings

☒ Yes ☐ No

- to review the affected credit ratings as soon as possible and not later than within 6 months after the change, and in the meantime place those ratings under observation

☒ Yes ☐ No

While CRAs are required to review the affected credit ratings, it will be left to the CRAs to determine how long such exercise would take. Indeed, the CRAs are required to take measures to publish without delay the range of potentially impacted credit ratings, that call for judgment on whether to update or not, as well as the period necessary for updating, and to conduct the necessary updates in the said period. Please see Article 306(1)(vi)(e) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

Disclosure and presentation of credit ratings

22. Are CRAs in your jurisdiction required to:

a. disclose any credit rating, as well as any decisions to discontinue a credit rating on a non-selective basis and in a timely manner? ☒ Yes ☐ No

b. disclose the decision to discontinue a credit rating including the reasons for such a decision?

☒ Yes ☐ No

c. differentiate the ratings of structured products by adding a specific symbol? ☒ Yes ☐ No

We basically require a CRA to differentiate the rating of structured products by adding a specific symbol. However, if the differentiation is not appropriate in terms of ensuring international consistency for a rating symbol, indications that clearly show that the determined credit rating is a credit rating related to an assessment of the credit status of a structured product is also acceptable. Please see Article 313(3)(iii)(k)2. of the Cabinet Office Ordinance on Financial Instruments Business, etc.

d. have a clear and fair policy in relation to unsolicited ratings, which shall be differentiated as such?

☒ Yes ☐ No

e. prominently state in the credit rating whether or not the rated entity or related third party participated in the credit rating process and whether the credit rating agency had access to the accounts and other relevant internal documents of the rated entity or its related third party, when a CRA issues an unsolicited credit rating? ☒ Yes ☐ No

f. ensure that they do not use the name of any relevant authority in such a way that would indicate or suggest endorsement or approval by that authority of the credit ratings or any credit rating activities of the CRA? ☒ Yes ☐ No

g. ensure that they state clearly and prominently the name and job title of the lead rating analyst in a given credit rating activity and the name and position of the person primarily responsible for approving the credit rating? ☒ Yes ☐ No

As to answers for Q22, please see Article 313(3) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

23. Are CRAs in your jurisdiction required to ensure that at least:

- all substantially material sources used to prepare the credit rating are indicated?

  ☒ Yes ☐ No

- the principal methodology or methodology version that was used in determining the rating is clearly indicated, with a reference to its comprehensive description? ☒ Yes ☐ No
- the meaning of each rating category and the definition of default or recovery is explained? ☒ Yes ☐ No
- the date at which the credit rating was first released for distribution and when it was last updated is indicated clearly and prominently? ☒ Yes ☐ No
- information on whether the credit rating concerns a newly issued financial instrument and whether the credit rating agency is rating the financial instrument for the first time?

  ☒ Yes ☐ No

As to answers for Q23, please see Articles 313(2) and 313(3) of the Cabinet Office Ordinance on Financial Instruments Business, etc. As to the last answer for Q23, please note that in cases where the credit rating concerns the securitized products and where the design of such products substantially deviates from the design of securitised products for which the CRAs have determined credit ratings in the past, the CRAs are required to provide that fact.

24. Are CRAs in your jurisdiction required to inform the entity subject to the rating at least 12 hours before publication of the credit rating and of the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors?

☐ Yes ☒ No

While CRAs will be required to provide rating stakeholders with credit ratings in advance so that rating stakeholders are able to check if there are factual errors or not, the minimum time for the provision of credit ratings are not specified. Concern would be rather greater for the potential problems which may occur from retaining material non-public information in the hands of a rating stakeholder. Please see Article 313(2)(iv) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

25. Are CRAs in your jurisdiction required to disclose to what extent it has examined the quality of information used in the rating process and whether it is satisfied with the quality of information it bases its rating on? ☒ Yes ☐ No

Please see Article 313(3)(iii)(j) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

26. Are CRAs in your jurisdiction required to state clearly and prominently when disclosing credit ratings any attributes and limitations of the credit rating? ☒ Yes ☐ No

Please see Article 313(3)(iii)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

27. Are CRAs in your jurisdiction required to refrain from issuing a credit rating or withdraw an existing rating if it does not have sufficient quality information to base its ratings on? ☒ Yes ☐ No

Please see Article 306(1)(vi)(c) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

28. Are CRAs in your jurisdiction required to explain in its press releases or reports the key elements underlying the credit rating when announcing a credit rating? ☒ Yes ☐ No

Please see Article 313(3)(iii)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

29. Are CRAs in your jurisdiction required to publish information on their historical performance data including the ratings transition frequency and information about credit ratings issued in the past and on their changes? ☒ Yes ☐ No

Please see Article 318(ii)(b)4. of the Cabinet Office Ordinance on Financial Instruments Business, etc.

Additional obligations in relation to credit ratings of structured finance instruments

30. Are CRAs required to provide in the credit ratings of structured finance instruments all information about:
    - loss and cash-flow analysis it has performed or is relying upon and ☒ Yes ☐ No
    - an indication of any expected change of the credit rating ☒ Yes ☐ No

where a CRA rates a structured finance instrument?

Please see Article 313(3)(iii)(k) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

31. Does your regulatory framework require that CRAs have to state what level of assessment they have performed concerning the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments? ☒ Yes ☐ No

32. Does your regulatory framework require a CRA to disclose whether it has undertaken any assessment of such due diligence processes or whether it has relied on a third-party assessment, indicating how the outcome of such assessment impacts the credit rating? ☒ Yes ☐ No

In cases where the assessment of the credit status of a structured product is the matter to be rated, reasonable measures for enabling a third party to examine the validity of a credit rating from an independent standpoint are required. Please see Article 306 (1)(ix) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

33. Does your regulatory framework require a CRA to disclose the models, methodologies and key assumptions on which it bases its ratings including clear and easily comprehensible guidance?

☒ Yes ☐ No

An outline of the credit rating determination policies, including the models, methodologies and key assumptions, will be required to be disclosed as shown in Article 318(iv) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

34. Does your regulatory framework require a CRA to disclose, on an ongoing basis, information about all structured finance products submitted to it for their initial review or for preliminary rating even when an issuer does not contract with the credit rating agency for a final rating? ☒ Yes ☐ No

Understanding from our interview is that the Section D(4) of ANNEX I in the EU Regulation, which would be the basis for this question, is not intended to reflect the IOSCO Code of Conduct 2.8(c). However, the disclosure requirements in the Japanese regulation which will enable a third party to examine the validity of a credit rating of a structured product in accordance with 2.8(c) of the IOSCO Code of Conduct is considered to serve the same purpose. Please see Article 306(1)(ix) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

3.3 Measures relating to ratings' quality and enhancing the transparency of the rating activity

Outsourcing

35. Are CRAs in your jurisdiction allowed to outsource important operational functions?
☒ No ☐ Yes (please explain briefly what activities can be outsourced!):

36. Do CRAs face any restrictions with respect to outsourcing?
☐ No ☒ Yes (please explain briefly what these restrictions are!):

In order to ensure integrity in the rating process, a CRA is requried to develop operational control systems to obtain registration. Furthermore, a CRA is not allowed to outsource the development of operational control systems.

37. How does the regulatory framework in your jurisdiction ensure that:
- none of the outsourced functions impair the quality of the CRAs internal controls?

The outsourced entities, together with an outsourcing CRA, shall develop operational control systems.

- outsourcing does not impair the ability of the relevant authority to supervise the CRAs compliance with its obligations under your jurisdiction's regulatory requirements?

In applying for registration, prospective CRAs shall include the information on outsourced entities.

An applicant is judged not to fulfil the requirement for the operational control systems if it outsources material operations and thus cannot complete a rating process by itself. In addition, a CRA will be prohibited from name lending. Please see Article 66-33 of the Act for the development of operational control systems and Article 66-34 of the Act for prohibition of name lending.

In the registration application form, an applicant shall write down not only the names of such legal entities as its parent company, subsidiaries, and fellow subsidiaries which determine and provide credit ratings, but also the names of other legal entities that work together to determine and provide credit ratings. As these items will be disclosed and on-site inspections may be conducted to outsourced entities, these will effectively prevent a deviation from regulation through outsourcing.

Disclosure

38. Are CRAs in your jurisdiction required to publicly disclose the following information on at least an annual basis? (Please tick) In the event that this information is not disclosed on an annual basis, please specify the frequency of disclosure.

a. detailed information about the:

- legal structure of the CRA ☒ Yes ☐ No
- ownership of the CRA ☒ Yes ☐ No
- financial information regarding its revenue streams ☒ Yes ☐ No

Please see Articles 318(i) and 318(ii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

b. a description of:

- the internal control mechanism ensuring quality of the credit rating activities ☒ Yes ☐ No
- the CRA's record-keeping policy ☒ Yes ☐ No
- the CRA's quality control system ☒ Yes ☐ No
- the CRA's management and analyst rotation policy ☒ Yes ☐ No

Please see Articles 318(iii)(a), 318(iii)(b) and 318(iii)(d) of the Cabinet Office Ordinance on Financial Instruments Business, etc. for contents of explanatory documents and Article 66-37 of the Act for record-keeping issues.

c. statistics on:

- staff allocation to new credit ratings ☒ Yes ☐ No
- credit rating reviews ☒ Yes ☐ No
- methodology or model appraisal ☒ Yes ☐ No
- senior management ☒ Yes ☐ No

Please see Article 318(iii)(d) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

d. the outcome of the internal review of the CRA's independence compliance function ☒ Yes ☐ No

Please see Article 318(iii)(c) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

e. other information not specified above (please explain briefly!):

In addition to the above items, a description of the compliance policy and the measure to prevent conflicts of interest needs to be disclosed. A CRA shall also disclose a general compensation arrangement.

In addition to the previous answer, a CRA is required to disclose history of its rating activity.

For how many years has the information mentioned in question 38 to be available to the public?

On-going basis (the information will be updated on an annual basis)

4. Supervisory issues

4.1 Personnel

39. How do you ensure that your authority is adequately staffed, with regard to capacity and expertise, in order to be able to apply the CRA regulation in your jurisdiction? (please explain briefly!):

Additional sections for the implementation of the CRA regulation have been and are to be established for legislation, supervision and inspection. Staff with adequate expertise and experiences have been and are to be allocated to such section.

4.2 Powers of the relevant authorities in jour jurisdiction

40. Are you or any other public authorities in your country allowed to influence the content of ratings or CRAs methodologies?
☒ No ☐ Yes (if yes please explain briefly!):

41. How do you ensure that your authority does not interfere with the content of ratings or CRAs methodologies? (please explain briefly!):

The Article 325 of the Cabinet Office Ordinances on Financial Instruments Business, etc. stipulates that the FSA shall pay due consideration not to interfere with the content of credit ratings and methodology for ratings.

42. Are you able to exercise your supervisory and investigative powers
- directly ☒ Yes ☐ No
- in collaboration with other entities ☒ Yes ☐ No
- by application to the competent judicial authorities ☒ Yes ☐ No

in order to carry out your duties under the regulation in your jurisdiction?

Please see Articles 66-41, 66-42 and 66-45 of the Act.

43. Does your authority have the following powers for use in your supervisory capacity on CRAs?
- power to access to any document in any form and to receive or take a copy thereof ☒ Yes ☐ No
- power to demand information from any person and if necessary to summon and question a person with a view to obtaining information ☒ Yes ☐ No
- power to carry out on-site inspections with or without announcement ☒ Yes ☐ No
- power to require records of telephone and data traffic ☒ Yes ☐ No

As the secrecy of communication is constitutionally guaranteed, an authority in Japan cannot normally acquire records of telephone and data traffic from telephone companies in the course of regulatory administration: in this context, the answer would be "No." However, it is possible that the FSA acquires records of telephone and data traffic from the CRAs themselves through a request of information or inspections. Please see Article 66-45 of the Act.

44. Where you have established that a registered CRA is in breach of the obligations arising from the relevant regulatory framework in your jurisdiction, does your authority have the power to use the following measures?

- withdraw the CRA's registration or authorisation? ☒ Yes ☐ No
- prohibit the CRA from temporarily, issuing credit ratings? ☒ Yes ☐ No
- suspend the use of credit ratings issued by the CRA for regulatory purposes? ☒ Yes ☐ No
- take appropriate measures to ensure that the CRA continues to comply with its legal requirements? ☒ Yes ☐ No
- issue public notices where the CRA is in breach of its obligations arising from the relevant regulatory framework in your jurisdiction ? ☒ Yes ☐ No
- refer matters for criminal prosecution to the relevant national authorities? ☒ Yes ☐ No

Please be noted that the uses of credit ratings for regulatory purposes are stipulated in other Cabinet Office Ordinances and Notifications. Hence, a suspension of the use of credit ratings for regulatory purposes could be ensured by stipulating it in those Ordinances and Notifications.

Please see Articles 66-41 and 66-42 of the Act. Please be noted that Article 66-43 of the Act stipulates that a violation of laws and regulations by CRAs will be notified.

4.3 Penalties

45. Does your legislation sets out penalties applicable to infringements of your regulatory framework?

☒ Yes ☐ No

Annex 3

Unofficial translation. Reference purposes only.

Regulation for CRAs (Outline of Cabinet Office Ordinances)

Definition

【Definition of credit rating】(Article 2 (34))
The term "credit rating" means a grade indicating the result of assessment regarding the credit status (creditworthiness) of financial instruments or legal persons using symbols or figures, except for such grades specified in a Cabinet Office Ordinance (※1) that are mainly determined by factors other than credit status.

【Definition of credit rating business】(Article 2 (35))
The term "credit rating business" means conducting on a professional basis such acts as determining credit ratings and either providing them to someone or making them available to the public (excluding those acts specified in a Cabinet Office Ordinance (※2) as being less likely to result in insufficient protection of investors in light of the scope of the counterparty and/or manners in which the acts are conducted).

【Definitions of credit rating agency】(Article 2 (36))
The term "credit rating agency (CRA)" means a person registered with the Prime Minister under Article 66-27 of the Act.

※1 (Grades mainly determined by factors other than credit status)
(Article 24(3) of COO on Definitions under Article 2 of the Financial Instruments and Exchange Act)
1. Market risk rating (fluctuations in interest rates, etc.)
2. Fund rating (performance of asset management, etc.)
3. Servicer rating (performance in managing and collecting debt, etc.)
4. Trustee rating (performance of trust companies in managing trust assets, etc.)

※2 (Acts precluded from the credit rating business)
(Article 25 of COO on Definitions under Article 2 of the Financial Instruments and Exchange Act)
1. The act of providing private credit ratings
2. The act of providing the results of computation using scoring models (only for small & medium sized enterprises)

Registration

【Registration】(Article 66-27)
A legal person engaged in credit rating business shall be entitled to be registered with the Prime Minister.

【Application for registration】(Article 66-28 (1))
A person who intends to be registered shall submit a written application for registration to the Prime Minister. In the case of a foreign legal person, it shall designate a representative in Japan (limited to an individual who takes charge of operations at all business offices established in Japan for credit rating business) or the equivalent, and submit the said written application for registration.

【Refusal of Registration】(Article 66-30)
1. The Prime Minister shall refuse registration when an applicant falls under the grounds for refusal (e.g., a legal person who is deemed not to have the organizational structure necessary for the fair and appropriate conduct of the credit rating business), or when a written application, etc. for registration contains false statements or records, or lacks statements or records about important facts.
2. In addition to the case in the first paragraph, the Prime Minister shall refuse registration when an applicant is a foreign legal person and does not have a business office or an establishment in Japan; however, this treatment shall not apply in cases specified in a Cabinet Office Ordinance (※4) as such where the applicant is deemed to be subject to appropriate supervision of the administrative agency in a foreign jurisdiction that oversees those who conduct businesses deemed to correspond to the credit rating business, or an organization equivalent to such an administrative agency, or in cases where the refusal of registration under the main clause of this paragraph would preclude sincere implementation of a treaty or any other international agreement.

【Notification of Changes】(Article 66-31 (1))
When there are changes in information submitted in the application, a CRA shall notify the Prime Minister of such changes within two weeks after they occur.

【Prohibited acts for a financial instruments business operator】(Article 38 (iii))
A financial instruments business operator, etc. or its executives or employees shall not conduct the act of soliciting a contract for a financial instruments transaction by referring to a credit rating (excluding those ratings specified in a Cabinet Office Ordinance as being less likely to result in insufficient protection of investors) determined by a person engaged in the credit rating business without registration, while not informing customers of the matters specified in a Cabinet Office Ordinance (※3) including the fact that the rating is determined by a non registered person and the significance of registration.

※3 (Matters to inform) (Article 116-3 of COO on Financial Instruments Business, etc.)
(* The fact that the person who determined the said credit rating is not registered as prescribed in Article 66-27 of the Act)
1. The significance of registration pursuant to the provisions of Article 66-27 of the Act
2. Business name, names of the executives, and locations, etc. with regard to the person who determined the said credit rating
3. Outline of the policies and methods used by the person who determined the said credit rating in determining the said credit rating
4. Assumptions, significance and limitations of the said credit rating

※4 At present, there is no article about such cases. In the course of time, cases may be set forth in a Cabinet Office Ordinance where the protection of Japanese investors and the effectiveness of inspection and supervision can be ensured without requiring establishment of a commercial presence in Japan, considering certain prerequisites (e.g., ① the authority of the home jurisdiction has a framework of supervision equivalent to that in Japan, ② the authority has the ability and the will to provide information about inspection, etc., and ③ reciprocity).

Regulations on Business

【Duty of good faith】【Article 66-32】
A CRA as well as its executives and employees shall execute their business for customers from an independent standpoint with fairness and integrity.

【Development of operational control systems】【Article 66-33】
1. A CRA shall develop its operational control systems pursuant to the provisions of a Cabinet Office Ordinance (※5) in order to conduct its credit rating business with fairness and adequacy.
2. The operational control systems shall include measures to maintain the quality of the CRA's business, including proper allocation of staff with expertise and skills, measures to prevent the undermining of investor interests with the aim to pursue interests of the CRA itself or a rating stakeholder (i.e., a person specified in a Cabinet Office Ordinance (※6) as having interests regarding the matters subject to the rating), and any other measures to ensure fairness in the business operation.

【Prohibition of name lending】【Article 66-34】
A CRA shall not have another person engage in credit rating business under its name.

【Prohibited acts】【Article 66-35】
A CRA or its executives or employees shall not conduct any of the following acts with regard to their credit rating business:
1. in cases where a CRA or its executives or employees have a close relationship specified in a Cabinet Office Ordinance (※7) with a rating stakeholder: an act of providing to someone or making available to the public, credit ratings on matters specified in a Cabinet Office Ordinance as those in which the said rating stakeholder has interests;
2. in cases where a CRA gives advice to a rating stakeholder on matters specified in a Cabinet Office Ordinance (※8) as those that may materially affect the credit ratings related to the said rating stakeholder: an act of providing to someone or making available to the public the said credit ratings (excluding cases where the CRA presents its rating policies, etc. specified in Article 66-36 (1) in response to the stakeholder's request, or cases specified in a Cabinet Office Ordinance as being less likely to result in insufficient investor protection considering the manner in which the advice is given); and
3. in addition to those listed in the preceding two paragraphs, any acts specified in a Cabinet Office Ordinance (※9) as resulting in insufficient protection of investors or loss of investor confidence in the credit rating business.

※5 Requirements of operational control systems: See the following pages

※6 (Rating stakeholders) 〔Article 307 of COO on Financial Instruments Business, etc.〕
1. For a credit rating on a legal person: the said legal person
2. For a credit rating on a financial instrument: the issuer
3. For a credit rating on a structured product (other than the two above): the issuer, the originator, and the arranger

※7 (Close relationships with rating stakeholders) 〔Article 308 of COO on Financial Instruments Business, etc.〕
1.① Cases where the CRA's staff in charge of the credit rating (i.e., rating analyst involved in the rating process, or a member of the rating committee) is an executive, etc. of the said rating stakeholder
② Cases where the CRA's staff in charge of the credit rating is a relative of an executive, etc. of the said ratings stakeholder
③ Cases where the CRA or its staff in charge of the credit rating holds securities issued by the said ratings stakeholder or owns options for derivative transactions (limited to securities issued by the said rating stakeholder or derivatives related to the said rating stakeholder)
2. The holders prescribed in 1③ include the following persons, in addition to a person who owns securities in the name of him/herself or another person (including a person who holds the right to request delivery of securities under a sales or purchase contract):
① A person who has the authority to exercise his/her voting rights as a shareholder of the issuer of securities, based on a money trust contract
② A person who has the authority necessary to make investments in securities, based on a discretionary investment contract

※8 (Matters that may materially affect the credit ratings) 〔Article 310 of COO on Financial Instruments Business, etc.〕
1. Organizational form of the rated legal person, and the composition of its major assets and liabilities
2. Design of the rated financial instruments (limited to designs that have material effects on the investment decisions of investors in the said financial instruments)

※9 (Prohibited acts) 〔Article 312 of COO on Financial Instruments Business, etc.〕
1. An act of promising a rating stakeholder in advance, before assessing the credit status, to provide to someone or make available to the public a certain credit rating as the result of such an assessment (excluding an act of providing a credit rating on a structured product to the rating stakeholder of the said structured product in advance)
2. An act by the CRA's staff in charge of the credit rating to either receive, request delivery of, or accept an offer of money or goods (excluding cases where the amount is less than JPY3,000 in the same day and is deemed necessary in the ordinary course of business) from rating stakeholders during the process pertaining to the determination of the said credit rating
3. An act of refusing the determination of a credit rating on a structured product, only on the grounds that other CRAs have already determined credit ratings on the assessment regarding the credit status of the rated structured product or its underlying assets

Requirements of operational control systems ①〔Article 306 (1) of COO on Financial Instruments Business, etc.〕

1. Measures to maintain the notion of fairness and integrity at all times, and conduct the credit rating business at one's own discretion and responsibility

2. In cases where a person involved in the credit rating process (including rating analysts) is successively involved in processes relating to the same rating stakeholder: measures (including any of the measures below) for executing business from a standpoint independent from the said rating stakeholder, with fairness and integrity:
   ① rotating lead analysts (five years with an interval of two years); or
   ② making final decisions on credit ratings at the rating committee, while preventing more than one-third of the total members of the said committee from being successively involved in processes pertaining to the determination of credit ratings of the same rating stakeholder (in cases where two or more credit ratings on the same rating stakeholder are determined within the same business year, the members may be successively involved)

3. Measures to prevent a person from being employed if the said person is significantly questionable in terms of conducting rating actions in a fair manner

4. Measures to develop the following systems so as to ensure the fairness of operations for the CRA:
   ① systems to ensure the efficiency of operations of the executive;
   ② systems to manage and maintain information related to the business operations of the executive; and
   ③ rules related to the management of a risk of loss

5. Measures (including the following) to ensure that the CRA complies with laws and regulations, etc. ("compliance with laws and regulations"):
   ① establishment of policies and procedures on compliance with laws and regulations;
   ② establishment of policies and procedures on the selection of a compliance officer and clarification of responsibility for compliance with laws and regulations; and
   ③ measures for responding to the cases where illegal actions are found by employees

11. Measures to prevent persons involved in the processes pertaining to the determination of credit ratings from participating in negotiations on fees to be paid to the CRA in exchange for the said credit rating service

6. Measures (including the following) related to the establishment and implementation of policies for quality control of processes in the determination of credit ratings:
   ① measures for securing sufficient personnel who have the expertise and skills necessary for the proper and smooth conduct of credit rating business;
   ② measures to ensure the quality of the information used in the determination of credit ratings;
   ③ measures to prevent credit ratings from being determined, in cases where personnel with expertise and skills for determining credit ratings cannot be sufficiently secured, or in cases where the quality of the information used in the determination of credit ratings cannot be ensured;
   ④ measures for developing functions whereby the validity and effectiveness of the credit rating determination policies, etc. are appropriately checked from an independent standpoint (including measures for appropriately checking the validity and effectiveness of the credit rating determination policies, etc. for a structured product, in cases where there has been a change in the characteristics of the credit standing of the underlying asset of that structured product);
   ⑤ when having made a material change to credit rating determination policies, etc.: measures to publish without delay the range of credit ratings determined pursuant to the said determination policies, etc., that call for judgment on whether to update or not pursuant to the revised determination policies, etc., as well as the period necessary for updating, and to conduct the necessary updates in the said period;
   ⑥ measures for developing a system to examine whether it is possible to properly determine credit ratings, in cases where the matter subject to rating is an assessment of the credit standing of a structured product, and the design of the said structured product is new to the CRAs; and
   ⑦ measures for reviewing and updating determined credit ratings in an appropriate and sustained manner (including, in cases where the said review and update will not be conducted, measures for publishing this fact and other necessary matters without delay)

10. Measures for establishing policies for determining the compensation, etc. of the executives and employees of a CRA (limited to those policies that satisfy all of the following requirements), and for ensuring that the said policies do not impede the fair and appropriate execution of the credit rating business (including measures pertaining to the development of a system for periodically reviewing the said policies):
   ① the amount of the compliance officer's compensation, etc. is not affected by the performance of the credit rating business; and
   ② the amount of compensation, etc. for persons involved in processes pertaining to the determination of credit ratings is not affected by the fees for the said credit rating services

Requirements of operational control systems ②　〔Article 306 (1) of COO on Financial Instruments Business, etc.〕

7. Measures (including the following) to prevent conflicts of interest pertaining to the credit rating business:
   ① measures (including the following) for specifying acts with conflicts of interest or potential conflicts of interest with regard to the credit rating business ("specified acts"), and ensuring that such acts do not undermine the interests of investors (measures for avoiding conflicts of interest):
      (a) measures to prevent persons involved in processes pertaining to the determination of credit ratings from selling or purchasing securities in which they have potential conflicts of interest;
      (b) in cases where there is potential conflict of interest between an executives or employee of the CRA and a rating stakeholder: measures for preventing the said executive or employee from participating in the processes pertaining to the determination of credit ratings on a matter related to the said rating stakeholder; and
      (c) in cases where there is potential conflict of interest between the CRA and a rating stakeholder (including the following cases): measures for ensuring the prevention of undermining the investor protection in determining credit ratings related to the said rating stakeholder:
         (i) cases where the CRA has obtained a loan from the said rating stakeholder;
         (ii) cases where the said rating stakeholder holds more than 5% of voting shares issued by the CRA;
         (iii) cases where the said rating stakeholder underwrites securities issued by the CRA; or
         (iv) cases where the CRA receives a large amount of consideration from the said rating stakeholder for services other than the credit rating service
      (d) measures for preventing a person in charge of the credit rating from approaching the rating stakeholder, etc. by him/herself with the purpose of being employed as an executive of the said rating stakeholder, etc.; and
      (e) in cases where a rating analyst, who has left the CRA, is employed as an executive of a rating stakeholder, etc.: measures for verifying the validity of credit ratings related to the said rating stakeholder (limited to credit ratings where the said analyst has been involved in the rating process, within two years prior to the separation)
   ② measures to publish specified acts and measures for preventing conflicts of interest

8. Measures to prevent associated or other services from unduly affecting credit rating actions

9. In cases where the assessment of the credit status of a structured product is the matter to be rated: reasonable measures (including the following) for enabling a third party to examine the validity of the said credit rating from an independent standpoint:
   ① arranging and publishing a list of information items that may be important for a third party in assessing the validity of the said credit rating;
   ② encouraging rating stakeholders to take measures enabling a third party to examine the validity of the said credit rating, including publishing information related to the said structured product (including items on the list published based on ①); and
   ③ publishing details and the results (i.e., results of the hearing from the rating stakeholders on the status of their publication of the information regarding the said structured product) of the encouragement by the CRA based on ②

12. Measures (including the following) to appropriately manage and maintain confidentiality of information learned during the course of the credit rating business:
   ① measures for ensuring that information and secrets learned during the course of the credit rating business are not used for any purposes other than those deemed necessary for conducting the credit rating business fairly and adequately; and
   ② measures to prevent the leakage of secrets, by specifying the scope of secrets and those who have access to them in the course of their duties, and by establishing methods for managing those secrets

13. Measures to process complaints against the CRA in an appropriate and expeditious manner (including measures related to the development of systems for reporting the said complaints to the executives of the said CRA)

14. Measures to conduct the credit rating business in accordance with rating policies, etc. (including measures pertaining to the training of analysts)

15. Measures to prevent false representation or indications that may be misleading on important matters, with regard to the general nature of the results of an assessment of credit status of a legal person or a financial instrument

16. In cases where associated services are conducted: measures to prevent false representation or indications that such services are related to credit rating business

17. Measures related to the development of a supervisory system at the CRA for ensuring that the measures regarding "business management and financial reporting," "compliance with laws and regulations, etc.," "quality control" and "prevention of conflicts of interest" are implemented appropriately (including the establishment of a supervisory committee which satisfies the following requirements):
   ① at least one-third of the supervisory committee members are independent members (excluding executives and employees of a CRA and its parent, subsidiary and fellow subsidiary companies, and those who have experienced such positions in the past five years);
   ② the majority of supervisory committee members have expertise pertaining to finance;
   ③ the amount of the independent members' remuneration, etc. is not affected by the performance of the credit rating business;
   ④ independent members can be dismissed only in limited situations such as having conducted wrongful acts; and
   ⑤ opinions of the independent members are reported to the supervisory committee on a regular basis

Regulations on Disclosure (Timely)

Unofficial translation. Reference purposes only.

【Rating policies, etc.】【Article 66-36】

1. A CRA shall establish policies and methods for determining and also either providing to someone or making available to the public the credit ratings ("rating policies, etc."), in accordance with the provisions of a Cabinet Office Ordinance (※10) (※11), and publish the said rating policies, etc. The same shall apply when the said CRA has changed its rating policies, etc.
2. A CRA shall conduct its credit rating business in accordance with its rating policies, etc.

※10 (Matters to be stated in rating policies, etc.) 【Article 313(1) of COO on Financial Instruments Business, etc.】

1. Rating policies, etc. shall describe the following matters:
   ① policies and methods pertaining to the determination of credit ratings ("credit rating determination policies, etc."); and
   ② policies and methods pertaining to the act of providing to someone or making available to the public the credit ratings ("credit rating provision policies, etc.")

※11 (Methods for publishing rating policies, etc.) 【Article 314 of COO on Financial Instruments Business, etc.】

1. A CRA shall publish rating policies, etc. via the internet or other means, so that investors and users of the credit ratings can view them easily.
2. When making a material change to rating policies, etc., a CRA shall publish in advance an indication that a change will be made and an outline thereof; however, in extreme circumstances the CRA shall publish promptly after the change the said circumstances, an indication that the change has been made, and an outline thereof.

Requirement for credit rating determination policies, etc.
〔Article 313(2) of COO on Financial Instruments Business, etc.〕

① shall be rigorous and systematic;
② shall require comprehensive judgments based on all the collected information and materials pertaining to the entity or financial instruments to be rated;
③ shall include a description of the following matters according to the categories and specifications of the credit ratings:
  (a) matters on which the assessment of credit status are based, the criteria used for setting the grades indicating the results of the assessment of credit status, and the explanation about the validity of the said criteria; and
  (b) an outline of methods pertaining to the determination of the credit ratings;
④ shall include a description of policies and methods that will enable rating stakeholders to check in advance factual errors with regard to key information used by the CRA in determining a credit rating, prior to the act of providing to someone or making it available to the public the said determined credit rating (including policies and methods for ensuring a reasonable amount of time needed for the said rating stakeholders to state their opinions); and
⑤ shall include a description of policies and methods pertaining to the determination of credit ratings in cases where the said credit ratings are determined without being solicited by a rating stakeholder

Requirement for credit rating provision policies, etc.
〔Article 313(3) of COO on Financial Instruments Business, etc.〕

① shall ensure that the determined credit ratings are provided to someone or made available to the public without delay;
② shall ensure that the acts in ① are targeting the public at large;
③ shall have the following matters published via the internet when taking the acts in ①:
  (a) the name and the registration number of the CRA, and details of the supervisory measures taken against itself over the past year;
  (b) the date of the determination of the credit rating;
  (c) the name of the lead analyst involved in the process pertaining to the determination of the credit ratings, and the name of the person responsible on behalf of the CRA for the determination of credit ratings;
  (d) an outline of the methods pertaining to the determination of the credit rating that was adopted, and an outline of the matters subject to the rating (including, if applicable, the fact that two or more credit rating determination policies, etc. have been adopted, and the reason thereof);
  (e) the names of the rating stakeholders (nondisclosure of the names of originator is permissible in certain cases);
  (f) in cases where the matter subject to the rating is an assessment of the credit status of a financial instrument, and the design of the said financial instrument is new to the CRA: that fact;
  (g) in cases where the credit ratings have been determined without being solicited by rating stakeholders: that fact, and whether unpublished information regarding the rating stakeholders has been acquired in the rating process;
  (h) in cases where a determined credit rating will not be updated: that fact, and the reason thereof;
  (i) explanations, corresponding to the categories of the rated matters, on the assumptions, significance and limitations of the determined credit rating (including an explanation on the characteristics of the fluctuation of the credit rating, and, in cases where the credit rating is on a financial instrument with limited historical data, the limitations of the said credit rating);
  (j) key information used in the determination of the credit rating:
    - an outline of the said information;
    - an outline of the measures taken to ensure the quality of the said information; and
    - the source of the said information;
  (k) in cases where the credit rating is on a securitized product: the following matters:
    - information on analysis of losses, cash flows, and sensitivity; and
    - symbols, numbers or other indications that clearly show that the determined credit rating is a credit rating related to an assessment of the credit status of a securitized product (including an explanation aimed at helping investors understand the significance and limitations of the credit rating based on the said indications);
④ shall ensure that the information relating to the withdrawal of a determined credit rating is provided without delay; and
⑤ shall not make indications that have the potential to cause misunderstanding that the Commissioner of the Financial Services Agency or other administrative organs have guaranteed the validity of the results of a credit assessment

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Regulations on Disclosure (Periodic)

【Explanatory documents made available to the public】(Article 66-39)

For each business year, a CRA shall prepare explanatory documents containing the matters specified in a Cabinet Office Ordinance (※12) concerning the status of its business, keep the said explanatory documents in all of its business offices and establishments and make them available to the public, as well as publish them, including via the internet, pursuant to the provisions of a Cabinet Office Ordinance for a year starting from the date after a certain period specified in a Cabinet Order (= four months) since the end of each business year.

Others

【Submission of business reports】(Article 66-38)

A CRA shall prepare a business report for each business year in accordance with the provisions of a Cabinet Office Ordinance and submit it to the Prime Minister within the period specified in a Cabinet Order (= three months) after the end of each business year.

【Books and Documents Related to Business】(Article 66-37)

A CRA shall prepare and keep books and documents regarding its credit rating business in accordance with a Cabinet Office Ordinance (※13).

※12 (Matters concerning the status of the CRA's business)
〔Article 318 of COO on Financial Instruments Business, etc.〕

1. The matters related to the overview of the CRA's business and its organization
2. The matters related to the status of the CRA's business:
   ① overview of the business in the latest business year
   ② indication of the status of the business in the latest business year
   (a) net sales figures (including the breakdown into compensation received for credit rating services and those for services other than credit rating);
   (b) in cases where the CRA receives remuneration from a single rating stakeholder exceeding ten percent of its total net sales (from credit rating business): the name or trade name of the said rating stakeholder;
   (c) statistics and other information related to changes in the credit status of a legal person or financial instrument;
   (d) information related to the history of the determined credit ratings (limited to those over one year of the day of the credit rating determination);
   (e) the status of associated and other services; and
   (f) the total number of rating analysts
3. Status of the development of operational control systems (including an outline of the following matters):
   ① measures for the CRA's executives and employees to execute their business from an independent standpoint, with fairness and integrity (in cases where measures are put in place to prevent any staff involved in the process of determining credit ratings from being involved successively for longer than a certain period of time in processes pertaining to the determination of credit ratings on matters in which the same rating stakeholder has interests: an outline of the said measures);
   ② measures to ensure the appropriateness of the business management;
   ③ measures taken for ensuring compliance with laws and regulations, etc.;
   ④ policies for the quality control of credit ratings, and measures for their implementation (including measures related to the allocation of rating analysts and other personnel, and measures for monitoring and updating determined credit ratings in an appropriate and sustained manner);
   ⑤ measures for identifying acts with potential conflicts of interest and for preventing such acts from undermining the interests of investors;
   ⑥ measures for checking the validity of the credit ratings rated by rating analysts who used to be executives or employees of the CRA;
   ⑦ measures to prevent associated and other services from unduly affecting credit ratings;
   ⑧ thoughts on the independence of independent members of the supervisory committee;
   ⑨ general remuneration system between the CRA and rating stakeholders; and
   ⑩ Code of Conduct
4. Outline of rating policies, etc.
5. Information related to the status of CRA's affiliated entities and subsidiaries

※13 (Books and documents) (Article 315 of COO on Financial Instruments Business, etc.)

1. CRAs shall prepare the following books and documents:
   ① records pertaining to the following matters related to the determined credit rating:
   (a) determined credit rating, the date of the determination, and the matters subject to rating;
   (b) information required for credit rating provision policies, etc.;
   (c) names of the rating analysts involved in the rating process and the person who has the primary responsibility for the determination of the credit rating at the CRA;
   (d) names of the rating committee members, materials submitted to the committee and other records, including the grounds for the decision making (in cases where determination does not involve the rating committee: that fact and the reason thereof);
   (e) in cases where a related legal person has been involved in the credit rating process: name and location of the said related legal person;
   (f) in cases where a credit assessment has been conducted based primarily on a quantitative analysis, and a material difference is observed between the result of the credit assessment based on the said quantitative analysis and the determined credit rating: key elements that have contributed to the said difference;
   (g) materials on which the determination of credit ratings is based (including records of negotiations with the rating stakeholders);
   (h) distinction between credit ratings determined without being solicited by rating stakeholders and those that are not;
   (i) outline of measures to check if there has been a conflict of interest between the CRA or its staff in charge of the ratings and rating stakeholders, and other measures to prevent conflicts of interest;
   ② records pertaining to the following matters related to rating stakeholders who have made payments to the CRA in exchange for its credit rating service:
   (a) their names or trade names and addresses;
   (b) the amount of consideration paid to the CRA; and
   (c) descriptions of the services offered by the CRA;
   ③ outline of the services or products provided by the CRA;
   ④ documents related to credit assessments prepared by rating analysts (including unpublished documents);
   ⑤ documents describing results of investigation into compliance status with laws and regulations, etc.;
   ⑥ documents related to specified acts and measures to prevent conflicts of interest;
   ⑦ minutes of the supervisory committee;
   ⑧ records on the course of material negotiations between executives or employees of the CRA and rating stakeholders (limited to those pertaining to the act of determining credit ratings, providing them to someone, or making them available to the public);
   ⑨ documents or electromagnetic records received from investors and other users of credit ratings (limited to those containing records of complaints related to credit rating activities); and
   ⑩ a general ledger.
2. Each of the books and documents listed in the previous paragraph shall be kept for a period of five years from the date of their preparation.

Supervision

【Business improvement orders】(Article 66-41)

With regard to a CRA's business operation, the Prime Minister may order the said CRA to change the methods of its business or take other necessary measures for improving its business operation, within necessary limits, when deemed necessary and appropriate for the public interest or protection of investors.

【Disposition for supervisory purposes】(Article 66-42)

1. In cases where a CRA falls under any of the following items, the Prime Minister may rescind its registration, or order suspension of all or part of its business by specifying a period not exceeding six months:
   ① when falling under grounds for refusal of registration;
   ② when obtaining registration through wrongful means;
   ③ when violating laws and regulations or administrative actions taken by government agencies under laws and regulations pertaining to the credit rating business;
   ④ when undermining the interests of investors with regard to operation of the credit rating business; and
   ⑤ when engaging in a wrongful or extremely unjust act with regard to the credit rating business, to an extent deemed especially serious.
2. When an executive of a CRA (in case of a foreign legal person, limited to executives stationed at business offices or establishments in Japan or the representative in Japan) comes to fall under the grounds for refusal of registration, or comes to fall under any of the items ③ to ⑤ in the preceding paragraph, the Prime Minister may order the said CRA to dismiss the said executive.

【Order for submission of a report and inspection】(Article 66-45)

When deemed necessary and appropriate for the public interest or protection of investors, the Prime Minister may order a CRA, a person who conducts transactions with the CRA, a person who has been entrusted with the CRA's business, or a related legal person (i.e., subsidiaries, parent companies, and fellow subsidiaries of a parent company) of the CRA to submit reports or materials that will be informative with regard to the CRA's business, or have the officials inspect the status of the business, or documents or other articles of the CRA, the person who has been entrusted with the CRA's business, or the related legal person of the CRA (with regard to the person who has been entrusted with the CRA's business or a related legal person of the CRA, the inspection shall be limited to the extent necessary to understand the business of the CRA).

(Article 325 of COO on Financial Instruments Business, etc.)

JFSA shall pay due consideration not to interfere with the content of credit ratings or the methodology for ratings.

Delegation

【Delegation of Authorities】(Article 194-7)

Prime Minister delegates its authorities prescribed in this Act to the Commissioner of the JFSA.

Exemption Scheme

(Articles 306(2) and 306(3) of COO on Financial Instruments Business, etc.)

Considering the number of executives and employees of CRAs and the nature, size, complexity and other circumstances of the business in which they are engaged, if they cannot comply with the rotation rule and the establishment of a supervisory committee but can alternatively take appropriate measures, they will be exempted from such requirements, provided that approval from the Commissioner of the JFSA is obtained.

(Article 306(6) of COO on Financial Instruments Business, etc.)

The specific requirements(*) of operational control systems will be exempted to a CRA operating globally and based in a foreign jurisdiction which chooses to register with JFSA, by application, if 1) a registered CRA can perform operations with the same level of fairness and adequacy by taking other alternative measures; and 2) the CRA is subject to appropriate supervision in its home jurisdiction on the proper functioning of the said alternative measures provided that approval from the Commissioner of the JFSA shall be obtained

(*) ※5 - 2, 4, 7①(c),(d),(e), 9, 17 on page 3-4

(Note in Guidelines for Supervision of CRAs)

In light of the core objectives of the Act, which are to fully utilize the functions of Japan's capital market and ensure investor protection in Japan, the credit ratings detemined by a CRA that is a foreign corporation, which are detemined at an overseas location, and which could not be brought into Japan will be outside the scope of the Act.

Annex 4a

(Translations are not official, but for reference purposes only.)

Financial Instruments and Exchange Act (Act No. 25 of 1948) related to Regulation on Credit Rating Agencies

Article 2 (Definitions)

(1) – (33) (omitted)

(34) The term "Credit Ratings" as used in this Act means a grade which indicates, by using symbols or figures (including those specified by Cabinet Office Ordinance as being similar thereto), the results of an assessment of the credit status of Financial Instruments or juridical persons (including those specified by Cabinet Office Ordinance as being similar thereto) (such assessment shall hereinafter be referred to as a "Creditworthiness" in this paragraph) (such grade shall exclude that specified by Cabinet Office Ordinance as a grade determined mainly by factors other than Creditworthiness).

(35) The term "Credit Rating Business" as used in this Act means conducting in the course of trade such acts as determining Credit Ratings and either providing them to someone or making them available to the public (excluding those acts specified by Cabinet Office Ordinance as being unlikely to result in insufficient protection of investors in light of the scope of the other party to the act and any other manner in which the acts are conducted).

(36) The term "Credit Rating Agency" as used in this Act means a person registered with the Prime Minister under Article 66-27 of the Act.

(37) – (39) (omitted)

Article 38 (Prohibited Acts)

A Financial Instruments Business Operator, etc. or Officers or employees thereof shall not conduct any of the following acts; provided, however, that in the case of the acts listed in items (iv) to (vi) inclusive, those specified by Cabinet Office Ordinance as acts that are not likely to result in insufficient protection of investors, harm the fairness of transactions or cause a loss of confidence in Financial Instruments Business shall be excluded:

(i) - (ii) (omitted)

(iii) an act of soliciting a Contract for a Financial Instruments Transaction by refering to a credit rating (excluding those Credit Ratings specified by Cabinet Office Ordinance as being unlikely to result in insufficient protection of investors) determined by a person engaged in the credit rating business without registration, while not informing said customers of the matters specified by Cabinet Office Ordinance including the fact that the rating is determined by said person who has determined the Credit Rating and has not obtained the registration under Article 66-27 and the matters specified by Cabinet Office Ordinance including the significance of said registration and any other matters, thereby soliciting him/her to conclude a Contract for Financial Instruments Transaction

(iv) – (vii) (omitted)

Chapter III-III Credit Rating Agency (Article 66-27 – Article 66-49)

Section 1 General Provisions

Article 66-27 (Registration)

A juridical person (including an organization without judicial personality for which a representative person or administrator has been designated; hereinafter the same shall apply in this Chapter, except in paragraph (1), item (ii) of the following Article and Article 66-47) engaged in Credit Rating Business may obtain the registration from the Prime Minister.

Article 66-28 (Application for Registration)

(1) A person who intends to obtain the registration set forth in the preceding Article shall submit a written application for registration containing the following matters to the Prime Minister. In this case, a foreign juridical person shall designate a representative person in Japan (limited to an individual who takes charge of business operations at all business offices or offices that said foreign juridical person establishes in Japan so as to engage in Credit Rating Business) or a person specified by Cabinet Office Ordinance as being equivalent thereto and submit said written application for registration:

(i) trade name or name;

(ii) name(s) of the Officer(s) (including the representative person or administrator of an organization without judicial personality for which a representative person or administrator has been designated; hereinafter the same shall apply in this Chapter);

(iii) name and location of the business office or office for Credit Rating Business (the head office, principal business office or office or any other business office or office in Japan, for a foreign juridical person);

(iv) the type of the person's other business(es), if any; and

(v) other matters specified by Cabinet Office Ordinance.

(2) The following documents shall be attached to the written application for registration set forth in the preceding paragraph:

(i) a document to pledge that the person does not fall under Article 66-30, paragraph (1), item (ii) or (iii);

(ii) a document that contains the matters specified by Cabinet Office Ordinance as the contents and methods of Credit Rating Business;

(iii) articles of incorporation and certificate of registered matters of the company (including documents equivalent thereto); and

(iv) other documents specified by Cabinet Office Ordinance.

(3) In the case referred to in item (iii) of the preceding paragraph, when the articles of incorporation are prepared in the form of an Electromagnetic Record, such Electromagnetic Record (limited to that specified by Cabinet Office Ordinance) may be attached in lieu of documents.

Article 66-29 (Registration in a Registry)

(1) When an application for registration set forth in Article 66-27 has been filed, the Prime Minister shall register the following matters in a registry of Credit Rating Agencies, except when he/she refuses the registration under the provisions of the following Article:
(i) the matters listed in the items of paragraph (1) of the preceding Article; and
(ii) the date of registration and registration number.

(2) The Prime Minister shall make the registry of Credit Rating Agencies available for public inspection.

Article 66-30 (Refusal of Registration)

(1) The Prime Minister shall refuse registration when an applicant falls under any of the following items, or when a written application for registration or documents or Electromagnetic Records to be attached thereto contain fake statements or records, or lack statements or records about important matters:
(i) a person other than a juridical person;
(ii) a juridical person who falls under Article 29-4, paragraph (1), sub-item (a) or (b);
(iii) a juridical person who has a person falling under any of sub-items (a) to (g) inclusive of Article 29-4, paragraph (2), item (ii) among its Officers;
(iv) a juridical person whose other business is found to be against the public interest; or
(v) a juridical person who is found not to have established a system necessary for the fair and appropriate performance of the Credit Rating Business.

(2) The Prime Minister shall, in addition to what is provided for in the preceding paragraph, refuse the registration when the applicant for registration has no business office or office in Japan in cases where the applicant for registration is a foreign juridical person; however, this shall not apply in cases specified by Cabinet Office Ordinance as such where the relevant applicant for registration is deemed to be subject to appropriate supervision of an administrative agency in foreign jurisdiction which supervises the person who conducts business deemed to correspond to Credit Rating Business, or any other organization equivalent to such agency, or in cases where the refusal of registration under the main clause of this paragraph shall preclude sincere implementation of treaties or any other international agreement.

Article 66-31 (Notification of Change)

(1) When there are any changes in the matters listed in the items of Article 66-28, paragraph (1), a Credit Rating Agency shall notify the Prime Minister to that effect within two weeks from the day of change.

(2) When the Prime Minister accepts a notification under the preceding paragraph, he/she shall register the notified matters in a registry of Credit Rating Agencies.

(3) When there are any changes in the matters stated in the documents listed in Article 66-28, paragraph (2), item (ii), a Credit Rating Agency shall notify the Prime Minister to that effect without delay, pursuant to the provisions of Cabinet Office Ordinance.

Section 2 Business

Article 66-32 (Duty of Good Faith)

A Credit Rating Agency as well as Officers and employees thereof shall execute their business in good faith and fairly from an independent standpoint.

Article 66-33 (Establishment of Operational Control Systems)

(1) A Credit Rating Agency shall establish operational control systems for the fair and appropriate performance of its Credit Rating Business, pursuant to the provisions of Cabinet Office Ordinance in order to conduct its Credit Rating Business with fairness and adequacy.

(2) The operational control systems referred to in the preceding paragraph shall include measures to maintain the quality of the business such as assigning persons with expert knowledge and skills, measures to prevent the undermining of the investors' interests for the purposes of pusuing its own interest or the interest of a Rating Stakeholders (meaning person specified by Cabinet Office Ordinance as those who have interest with regard to the matters subject to theCredit Ratings; the same shall apply in Article 66-35) and any other measures for ensuring fairness in the business operation.

Article 66-34 (Prohibition of Name Lending)

A Credit Rating Agency shall not have another person engage in Credit Rating Business under the name of said Credit Rating Agency.

Article 66-35 (Prohibited Acts)

A Credit Rating Agency or the Officers or employees thereof shall not conduct any of the following acts with regard to their Credit Rating Business:

(i) in cases where the Credit Rating Agency or the Officers or employees thereof have a close relationship specified by Cabinet Office Ordinance with a Rating Stakeholder, an act of providing to someone or making available to the public, Credit Ratings on matters specified by Cabinet Office Ordinance as those in which the said rating stakeholders has interests;

(ii) in cases where the Credit Rating Agency or the Officers or employees thereof have given advice to a rating stakeholder on matters specified by Cabinet Office Ordinance as those that may have material influence on the Credit Rating related to the said Rating Stakeholderer (excluding cases where the Credit Rating Agency or the Officers or employees thereof have provided the details of the Rating Policy, etc. as defined in paragraph (1) of the following Article in response to the request from the said rating stakeholder or other cases specified by Cabinet Office Ordinance as being less likely to result in insufficient protection of investors in light of the manner of advice), an act of providing to someone or making available to the public the said Credit Ratings; and

(iii) in addition to what is listed in the preceding two items, acts specified by Cabinet Office Ordinance as those resulting in insufficient protection of investors or causing a loss of confidence in Credit Rating Business.

Article 66-36 (Rating Policy, etc.)

(1) A Credit Rating Agency shall, pursuant to the provisions of Cabinet Office Ordinance, establish the policies and methods for determining and also either providing to someone or making available to the public the Credit Ratings (such policies shall collectively referred to as the "Rating Policy, etc." in the following paragraph) and publish the said Rating Policy, etc. The same shall apply when the Credit Rating Agency has changed the Rating Policy, etc.

(2) A Credit Rating Agency shall conduct its Credit Rating Business in accordance with its Rating Policy, etc.

Section 3 Accounting

Article 66-37 (Books and Documents Related to Business)

A Credit Rating Agency shall, pursuant to the provisions of Cabinet Office Ordinance, prepare and preserve the books and documents related to its Credit Rating Business.

Article 66-38 (Submission of Business Reports)

A Credit Rating Agency shall, pursuant to the provisions of Cabinet Office Ordinance, prepare a business report for each business year, and submit it to the Prime Minister within the period specified by Cabinet Order after the end of each business year.

Article 66-39 (Public Inspection of Explanatory Documents)

A Credit Rating Agency shall, for each business year, prepare explanatory documents containing the matters specified by Cabinet Office Ordinance as the matters concerning status of business, and keep the said explanatory documents at all of its business offices or offices and make them available for public inspection, as well as publicizing them via the Internet or by any other method pursuant to the provisions of Cabinet Office Ordinance, for one year from the day on which the period specified by Cabinet Order has elapsed after the end of each business year.

Section 4 Supervision

Article 66-40 (Notification, etc. of Discontinuance of Business, etc.)

(1) When a Credit Rating Agency has come to fall under any of the following items, the person specified in the respective items shall notify the Prime Minister to that effect within 30 days from such day:

(i) when the Credit Rating Agency has abolished its Credit Rating Business (including cases when said Credit Rating Agency has had all of its business (limited to those related to Credit Rating Business; hereinafter the same shall apply in this Article) succeeded to as a result of company split or has transferred all of its business): the juridical person who has abolished or transferred its Credit Rating Business or has had its Credit Rating

Business succeeded to;

(ii) when the juridical person who is a Credit Rating Agency has been extinguished as a result of merger: the person who was an Officer representing such juridical person;

(iii) when the juridical person who is a Credit Rating Agency has dissolved as a result of decision of commencement of bankruptcy proceedings: the bankruptcy trustee thereof; and

(iv) when the juridical person who is a Credit Rating Agency has dissolved on grounds other than a merger or decision of commencement of bankruptcy proceedings.

(2) When a Credit Rating Agency has come to fall under any of the items of the preceding paragraph, the registration under Article 66-27 of said Credit Rating Agency shall lose its effect.

(3) When a Credit Rating Agency intends to apply for the deletion of registration under Article 66-27, to abolish its Credit Rating Business, to implement a merger (limited to a merger in which said Credit Rating Agency is extinguished as a result of merger), to dissolve on grounds other than a merger or a decision of commencement of bankruptcy proceedings, to have all of its business succeeded to as a result of company split or transfer all of its business, it shall, by 30 days prior to that day, give public notice to that effect, pursuant to the provisions of Cabinet Office Ordinance.

(4) When a Credit Rating Agency has given the public notice under the preceding paragraph, it shall immediately notify the Prime Minister to that effect.

(5) The provisions of Article 940, paragraph (1) (limited to the part pertaining to item (i)) and paragraph (3) of that Article of the Companies Act shall apply mutatis mutandis to the case where a Credit Rating Agency (limited to a company) gives the public notice set forth in paragraph (3) by means of Electronic Public Notice. In this case, any necessary technical replacement of terms shall be specified by Cabinet Order.

(6) The provisions of Article 940, paragraph (1) (limited to the part pertaining to item (i)) and paragraph (3) of that Article, Article 941, Article 946, Article 947, Article 951, paragraph (2), Article 953, and Article 955 of the Companies Act shall apply mutatis mutandis to the case where a Credit Rating Agency (limited to a foreign company) gives the public notice set forth in paragraph (3) by means of Electronic Public Notice. In this case, any necessary technical replacement of terms shall be specified by Cabinet Order.

Article 66-41 (Order to Improve Business Operation)

When the Prime Minister finds it necessary and appropriate for the public interest or protection of investors, with regard to the status of Credit Rating Agency's business operations, he/she may order said Credit Rating Agency to change its business methods or take other necessary measures for improving the status of business operations, within the limit necessary.

Article 66-42 (Disposition Rendered for the Purpose of Supervision)

(1) In cases where a Credit Rating Agency falls under any of the following items, the Prime Minister may rescind its registration under Article 66-27, or order suspension of all or

part of its business by specifying a period not exceeding six months:

(i) when the Credit Rating Agency has come to fall under any of the items (excluding item (iii)) of Article 66-30, paragraph (1);

(ii) when the Credit Rating Agency has come to fall under the grounds upon which the registration shall be refused under Article 66-30, paragraph (2),

(iii) when the Credit Rating Agency has obtained the registration under Article 66-27 by wrongful means;

(iv) when the Credit Rating Agency has violated laws and regulations or dispositions given by a government agency based on laws and regulations with regard to its Credit Rating Business;

(v) when there are facts that undermine the investors' interest with regard to the operations of Credit Rating Business; or

(vi) when a wrongful act or extremely unjust act has been conducted with regard to Credit Rating Business, and when the circumstances are especially serious.

(2) A Prime Minister may, when an Officer(s) (limited to the Officer stationed at the business office or office in Japan or to the representative person in Japan, for a foreign juridical person; hereinafter the same shall apply in this paragraph) of a Credit Rating Agency has come to fall under any of sub-items (a) to (g) inclusive of Article 29-4, paragraph (1), item (ii), is found to have already fallen under any of sub-items (a) to (g) inclusive of that item at the time of the registration under Article 66-27, or has come to fall under any of the items (iv) to (vi) inclusive of the preceding paragraph, order said Credit Rating Agency to dismiss such Officer(s).

(3) When the locations of business offices or offices of a Credit Rating Agency are not ascertained or the whereabouts of an Officer representing the Credit Rating Agency is not ascertained, the Prime Minister shall give a public notice to that effect pursuant to the provisions of Cabinet Office Ordinance, and may rescind registration of said Credit Rating Agency if no request has been submitted by said Credit Rating Agency even after 30 days since the day of the public notice.

(4) The provisions of Chapter III of the Administrative Procedure Act shall not apply to the disposition under the preceding paragraph.

Article 66-43 (Public Notice of Supervisory Disposition)

When the Prime Minister has rescinded the registration under Article 66-27 pursuant to the provisions of paragraph (1) or (3) of the preceding Article or has ordered the suspension of all or part of the business pursuant to paragraph (1) of the preceding Article, he/she shall give public notice to that effect, pursuant to the provisions of Cabinet Office Ordinance.

Article 66-44 (Deletion of Registration)

When an application for deletion of registration under Article 66-27 has been filed by a Credit Rating Agency, the registration under Article 66-27 has lost its effect under the provisions of Article 66-40, paragraph (2), or the Prime Minister has rescinded registration under Article 66-27 under the provisions of Article 66-42, paragraph (1) or (3), the Prime

Minister shall delete said registration.

Article 66-45 (Order for the Production of Reports and Inspection)

(1) When the Prime Minister finds it necessary and appropriate for the public interest or protection of investors, he/she may order a Credit Rating Agency, a person who conducts transactions with the Credit Rating Agency, a person who has received entrustment of business from the Credit Rating Agency, or the Associated Juridical Person of the Credit Rating Agency (such Associated Juridical Person means the Subsidiary Juridical Person of the Credit Rating Agency, a juridical person who has the Credit Rating Agency as its Subsidiary Juridical Person or a Subsidiary Juridical Person of the juridical person who has the Credit Rating Agency as its Subsidiary Juridical Person (excluding the Credit Rating Agency) who is a juridical person that conduct acts of determining Credit Ratings, or providing them to someone or making them available to the public in the course of trade; hereinafter the same shall apply in this paragraph) to submit reports or materials that will be helpful for understanding the business of the Credit Rating Agency, or have the officials inspect the status of the business, documents, or other articles of the Credit Rating Agency, the person who received entrustment of business from the Credit Rating Agency, or the Associated Juridical Person of the Credit Rating Agency (with regard to the person who has received entrustment of business from the Credit Rating Agency or the Associated Juridical Person of the Credit Rating Agency, the inspection shall be limited to what is necessary to understand the business of the Credit Rating Agency).

(2) The term "Subsidiary Juridical Person" as used in the preceding paragraph means another juridical person, the majority of whose Voting Rights Held by All the Shareholders, etc. are held by a juridical person. In this case, the other juridical person, the majority of whose Voting Rights Held by All the Shareholders, etc. are held by the juridical person and one or more of its Subsidiary Juridical Persons or by one or more of the Subsidiary Juridical Person of the juridical person, shall be deemed as a Subsidiary Juridical Person of said juridical person.

Article 66-46 (Acting Representative Person)

(1) When there is any vacancy in the office of the Credit Rating Agency (limited to a foreign juridical person; hereinafter the same shall apply in this Article), if the Prime Minister finds it necessary, he/she may appoint a person who shall temporarily perform the duty of the representative person in Japan (referred to as the "Acting Representative Person" in the following paragraph). In this case, the Credit Rating Agency shall conduct the registration for such appointment at the location of the principal business office or office in Japan.

(2) When the Prime Minister has appointed an Acting Representative Person under the provisions of the preceding paragraph, he/she may order the Credit Rating Agency to pay a reasonable amount of remuneration to the Acting Representative Person.

Article 66-47 (Technical Replacement of Terms, etc. for Application of Provisions of

This Act to a Foreign Juridical Person, etc.)

In cases where a Credit Rating Agency is a foreign juridical person or an organization without judicial personality for which a representative person or administrator has been designated, the technical replacement of terms for the application of the provision of this Act and other necessary matters concerning the application of the provision of this Act to said foreign juridical person or organization without judicial personality for which a representative person or administrator has been designated shall be specified by Cabinet Order.

Article 66-48 (Application Mutais Mutandis)

The provisions of Article 57, paragraphs (1) and (3) shall apply mutatis mutandis to the registration under Article 66-27, and the provisions of Article 57, paragraphs (2) and (3) and Article 65-6 shall apply mutatis mutandis to a Credit Rating Agency. In this case, any necessary technical replacement of terms shall be specified by Cabinet Order.

Article 66-49 (Delegation to Cabinet Office Ordinance)

The procedures and any other matters necessary for implementation of the provisions of Article 66-27 to the preceding Article inclusive shall be specified by Cabinet Office Ordinance.

Article 194-7 (Delegation of Authority to Commissioner of Financial Services Agency)

(1) The Prime Minister shall delegate to the Commissioner of the Financial Services Agency the authority vested under this Act (except those specified by Cabinet Order).

(2) The Commissioner of the Financial Services Agency shall delegate to the Securities and Exchange Surveillance Commission (hereinafter referred to as the "Commission" in this and the following Articles) the authority listed in the following, within the scope of authority delegated under the provisions of the preceding paragraph; provided, however, that the foregoing sentence shall not preclude the Commissioner of the Financial Services Agency from exercising his/her authorities to issue an order of submission of reports or materials:

(i) – (iii) (omitted)

(iii)-2 authority vested under the provisions of Article 66-45, paragraph (1) (limited to authority related to the provisions specified by Cabinet Order as that for securing fairness in the acts prescribed in Article 2, paragraph (35));

(iv) – (ix) (omitted)

(3) The Commissioner of the Financial Services Agency may, pursuant to the provisions of Cabinet Order, delegate to the Commission the authority vested under Article 26 (including the cases where it is applied mutatis mutandis pursuant to Article 27), Article 27-22, paragraph (1) (including the cases where it is applied mutatis mutandis pursuant to Article 27-22-2, paragraph (2)) and Article 27-22, paragraph (2), Article 27-30, Article 27-35, Article 56-2, paragraph (1) (including the cases where it is applied mutatis mutandis pursuant to Article 65-3, paragraph (3)), Article 56-2, paragraph (2) to

paragraph (4) inclusive, Article 60-11 (including the cases where it is applied mutatis mutandis pursuant to Article 60-12, paragraph (3), Article 63, paragraphs (7) and (8), Article 66-22, Article 66-45, paragraph (1), Article 75, Article 79-4, Article 79-77, Article 103-4, Article 106-6, paragraph (1) (including the cases where it is applied mutatis mutandis pursuant to paragraph (2) of that Article), Article 106-16, Article 106-20, paragraph (1) (including the cases where it is applied mutatis mutandis pursuant to paragraph (2) of that Article), Article 106-27 (including the cases where it is applied mutatis mutandis pursuant to Article 109), Article 151 (including the cases where it is applied mutatis mutandis pursuant to Article 153-4), Article 155-9, Article 156-15, Article 156-34, Article 156-58 and Article 193-2, paragraph (6), within the scope of authority delegated under the provisions of paragraph (1) (excluding the authorities delegated to the Commission under the provisions of the preceding paragraph).

(4) – (8) (omitted)

Article 198

A person who falls under any of the following items shall be punished by imprisonment with work for not more than three years or by a fine of not more than three million yen, or both:

(i) (omitted)

(ii) a person who has obtained registration under Article 29, Article 66 or Article 66-27, registration of change under Article 31, paragraph (4), or permission under Article 59, paragraph (1) or Article 60, paragraph (1) by wrongful means;

(iii) a person who has, in violation of Article 36-3, Article 66-9 or Article 66-34, made other persons conduct Financial Instruments Business, Registered Financial Institution Business, Financial Instruments Intermediary Service or Credit Rating Business;

(iii)-2 – (viii) (omitted)

Article 198-5

In the case of act of violation set forth in any of the following items, a representative person, agent, employee or other worker of a Financial Instruments Business Operator, etc., Authorized Transaction-at-Exchange Operator, Financial Instruments Intermediary Service Provider, Credit Rating Agency, Authorized Financial Instruments Firms Association or Recognized Financial Instruments Firms Association prescribed in Article 78, paragraph (2), Financial Instruments Exchange, Self-Regulation Organization prescribed in Article 85, paragraph (1), Financial Instruments Exchange Holding Company, Foreign Financial Instruments Exchange, Financial Instruments Clearing Organization, or Securities Finance Company, or a Financial Instruments Business Operator or Financial Instruments Intermediary Service Provider that has committed such act shall be punished by imprisonment with work for not more than two years or by a fine of not more than three million yen, or both:

(i) (omitted)

(ii) act of violating the disposition of the suspension of business under Article 52,

paragraph (1), Article 53, paragraph (2), Article 60-8, paragraph (1), Article 66-20, paragraph (1) or Article 66-42, paragraph (1) (excluding the disposition of the suspension of business pertaining to authorization under Article 30, paragraph (1));

(iii)-(iv) (omitted)

Article 198-6

Any person who falls under any of the following items shall be punished by imprisonment with work for not more than one year or by a fine of not more than three million yen, or both:

(i) a person who has entered a fake statement or record into written applications or documents to be attached thereto or Electromagnetic Records under Article 29-2, paragraphs (1) to (3) inclusive, Article 33-3, Article 59-2, paragraph (1) or (3), Article 60-2, paragraph (1) or (3), Article 66-2, Article 66-28, Article 67-3, Article 81, Article 102-15, Article 106-11, Article 155-2, Article 156-3, Article 156-24, paragraphs (2) to (4) inclusive or Article 156-40 and submitted them;

(ii) (omitted)

(iii) a person who has failed to prepare or preserve documents under Article 46-2 (including the cases where it is applied mutatis mutandis pursuant to Article 60-6), Article 47, Article 48, Article 66-16, Article 66-37, or Article 188, or prepared false documents;

(iv) a person who has failed to submit reports, documents or written documents under Article 46-3, paragraph (1) (including the cases where it is applied mutatis mutandis pursuant to Article 60-6), Article 47-2, Article 48-2, paragraph (1), Article 49-3, paragraph (1) (including the cases where it is applied mutatis mutandis pursuant to Article 60-6), Article 66-17, paragraph (1), Article 66-38, Article 155-5, Article 156-35 or Article 156-57, paragraph (1) or submitted reports, documents or written documents containing fake statements;

(v) – (vi) (omitted)

(vi)-2 a person who has failed to make explanatory documents under Article 66-39 available for public inspection or who has provided explanatory documents containing fake statements for public inspection or who has failed to make the publication under that Article or who has made a false publication;

(vii) (omitted)

(viii) a person who has failed to make a notification under Article 50-2, paragraph (1) or (7), Article 60-7 or Article 66-40, paragraph (1) or (4), or made a false notification;

(ix) a person who has failed to make a public notice under Article 50-2, paragraph (6) or Article 66-40, paragraph (3), or made a false public notice;

(x) a person who has failed to make a report or submit materials under Article 56-2, Article 60-11, Article 63, paragraph (7), Article 66-22, Article 66-45, paragraph (1), Article 103-4, Article 106-6, paragraph (1), Article 106-16, or Article 106-20, paragraph (1) or made a false report or submitted false materials;

(xi) a person who has refused, hindered, or avoided inspections under Article 56-2, Article 60-11, Article 63, paragraph (8), Article 66-22, Article 66-45, paragraph (1), Article 75,

Article 79-4, Article 103-4, Article 106-6, paragraph (1) (including the cases where it is applied mutatis mutandis pursuant to paragraph (2) of that Article), Article 106-16, Article 106-20, paragraph (1) (including the cases where it is applied mutatis mutandis pursuant to paragraph (2) of that Article), Article 106-27 (including the cases where it is applied mutatis mutandis pursuant to Article 109), Article 151 (including the cases where it is applied mutatis mutandis pursuant to Article 153-4), Article 155-9, Article 156-15, Article 156-34, Article 185-5 or Article 187(iv);

(xii) – (xviii) (omitted)

Article 205-2-3

A person who falls under any of the following items shall be punished by a fine of not more than 300 thousand yen:

(i) a person who has failed to make a notification under Article 31, paragraph (1) or (3), Article 32-3 (including the cases where it is applied mutatis mutandis pursuant to Article 32-4), Article 33-6, paragraph (1) or (3), Article 35, paragraph (3) or (6), Article 50, paragraph (1), Article 60-5, Article 63, paragraph (3), Article 63-2, paragraph (2), Article 63-2, paragraph (3) (including the cases where it is applied mutatis mutandis pursuant to Article 63-3, paragraph (2)) or Article 63-2, paragraph (4), Article 64-4 (including the cases where it is applied mutatis mutandis pursuant to Article 66-25), Article 66-5, paragraph (1) or (3), Article 66-19, paragraph (1), Article 66-31, paragraph (1) or (3), Article 79-27, paragraph (4), Article 106-3, paragraph (5) (including the cases where it is applied mutatis mutandis pursuant to Article 106-10, paragraph (4) and Article 106-17, paragraph (4)), Article 156-55, paragraph (1), Article 156-56, or Article 156-60, paragraph (2) or given a false notification;

(ii) – (v) (omitted)

(vi) a person who has, in violation of Article 955, paragraph (1) of the Companies Act as applied mutatis mutandis pursuant to Article 50-2, paragraph (10) and Article 66-40, paragraph (6), failed to enter or record matters specified by an Ordinance of the Ministry of Justice with regard to electronic public notice investigations under that paragraph in Investigation Record Book, etc. (meaning Investigation Record Book, etc. prescribed in Article 955, paragraph (1) of the Companies Act; hereinafter the same shall apply in this item), or entered or recorded a fake statement, or who has, in violation of that paragraph, failed to preserve Investigation Record Book, etc.;

(vii) – (xiv) (omitted)

Article 207

(1) Where the representative person of a juridical person (including organizations without judicial personality for which a representative person or administrator has been designated; hereinafter the same shall apply in this paragraph and the following paragraph) or an agent, employee, or other worker of a juridical person or individual has, with regard to the business or property of the juridical person or individual, violated any of the provisions set forth in the following items, not only shall the offender be punished

but also said juridical person shall be punished by the fine prescribed in the respective items and said individual shall be punished by the fine prescribed in the provisions referred to in the respective items:

(i) – (iii) (omitted)

(iv) Article 198-6 (excluding items (viii), (ix), (xii), (xiii), and (xv)) or Article 199: a fine of not more than 200 million yen;

(v) (omitted)

(vi) Article 198 (excluding items (v) and (viii)), Article 198-6, item (viii), (ix), (xii), (xiii) or (xv), Article 200, item (xvii), (xviii)-2, or (xix), Article 201 (excluding items (i), (ii), (iv), (vi), (ix) to (xi) inclusive), Articles 205 to 205-2 inclusive, Article 205-2-3 (excluding items (xiii) and (xiv)), or the preceding Article (excluding item (v)): the fine prescribed in the respective Articles.

(2) – (3) (omitted)

Article 207-4

A person who falls under any of the following items shall be punished by a non-penal fine of not more than one million yen:

(i) a person who has, in violation of Article 941 of the Companies Act as applied mutatis mutandis pursuant to Article 50-2, paragraph (10) and Article 66-40, paragraph (6), failed to request investigation under Article 941 of the Companies Act;

(ii) a person who has, in violation of Article 946, paragraph (3) of the Companies Act as applied mutatis mutandis pursuant to Article 50-2, paragraph (10) and Article 66-40, paragraph (6), failed to make a report or has made a false report;

(iii) a person who has refused requests set forth in the items of Article 951, paragraph (2) or Article 955, paragraph (2) of the Companies Act which are applied mutatis mutandis pursuant to Article 50-2, paragraph (10) and Article 66-40, paragraph (6), without justifiable grounds; or

(iv) (omitted)

Article 208

An Issuer of Securities, a representative person or Officer of a Financial Instruments Business Operator or Financial Instruments Intermediary Service Provider, a Financial Instruments Business Operator or Financial Instruments Intermediary Service Provider, a Financial Instruments Business Operator which is a foreign juridical person, a person who has received permission under Article 59 or representative person of an Authorized Transaction-at-Exchange Operator in Japan, an Officer of a Credit Rating Agency (including the representative person or administrator of an organization without judicial personality for which a representative person or administrator has been designated), a representative person in Japan of a Credit Rating Agency which is a foreign juridical person (including an organization without judicial personality for which a representative person or administrator has been designated), an Officer (including a provisional board member) or person who used to be a representative person of an Authorized Financial Instruments Firms

Association or Recognized Financial Instruments Firms Association prescribed in Article 78, paragraph (2), an Officer (including a provisional board member and provisional auditor) or liquidator of an Investor Protection Fund, an Officer (including a provisional board member and provisional executive officer), person who used to be a representative person, or liquidator of a Financial Instruments Exchange or Self-Regulation Organization prescribed in Article 85, paragraph (1), a representative person or person who used to be a representative person of a Foreign Financial Instruments Exchange in Japan, a representative person or Officer of a Financial Instruments Clearing Organization, a representative person or Officer of a Securities Finance Company or an Officer of a Designated Dispute Resolution Organization defined in Article 156-38, paragraph (1) (including the representative person or administrator of an organization without judicial personality for which a representative person or administrator has been designated) shall be punished by a non-penal fine of not more than 300 thousand yen in the following cases:

(i) – (vii) (omitted)

(viii) when having violated orders under Article 51, Article 51-2, Article 53, paragraph (1), Article 60-8, paragraph (1), Article 66-20, paragraph (1), Article 66-41, Article 79-37, paragraph (5), Article 79-75, Article 156-16 or Article 156-33, paragraph (1) (in the case of orders under Article 60-8, paragraph (1) or Article 66-20, paragraph (1), excluding disposition of the suspension of business);

(ix) – (xxvii) (omitted)

Article 209

Any person who falls under any of the following items shall be punished by a non-penal fine of not more than 100 thousand yen:

(i) – (vi)-2 (omitted)

(vii) a person who has violated orders under Article 60-4, paragraph (2), Article 65, paragraph (2) or Article 66-46, paragraph (2);

(viii) – (xiii) (omitted)

Annex 4b

(Translations are not official, but for reference purposes only.)

Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act (Ordinance of the Ministry of Finance No. 14 of 1993) related to Regulation on Credit Rating Agencies

Article 1 (Definitions)

(1) As used in this Cabinet Office Ordinance, the term “Securities,” “Public Offering of Securities,” “Private Placement of Securities,” “Secondary Distribution of Securities,” “Issuer,” “Financial Instruments Business,” “Financial Instruments Business Operator,” "Financial Instruments Market," “Financial Instruments Exchange,” “Derivative Transaction,” “Market Transaction of Derivatives,” “Over-the-Counter Transaction of Derivatives,” “Foreign Market Derivatives Transaction,” “Financial Instruments,” “Financial Indicator,” “Brokerage for Clearing of Securities, etc.,” “Professional Investor,” "Specified Listed Securities," or "Credit Rating" shall respectively mean Securities, Public Offering of Securities, Private Placement of Securities, Secondary Distribution of Securities, Issuer, Financial Instruments Business, Financial Instruments Business Operator, Financial Instruments Market, Financial Instruments Exchange, Derivative Transaction, Market Transaction of Derivatives, Over-the-Counter Transaction of Derivatives, Foreign Market Derivatives Transaction, Financial Instruments, Financial Indicator, Brokerage for Clearing of Securities, etc., Professional Investor, Specified Listed Securities or Credit Rating as defined in Article 2 of the Financial Instruments and Exchange Act (Act No. 25 of 1948; hereinafter referred to as the “Act”).

(2) – (3) (omitted)

Article 24 (Scope of Credit Ratings)

(1) Those similar to a juridical person as specified by Cabinet Office Ordinance, as referred to in Article 2, paragraph (34) of the Act, shall be as follows:

(i) an organization without juridical personality;

(ii) an individual who carries out business;

(iii) a group of juridical persons or individuals; and

(iv) trust property.

(2) Those similar to symbols or figures as specified by Cabinet Office Ordinance, as referred to in Article 2, paragraph (34) of the Act shall be a simple text or character showing sequential orders.

(3) The grades to be specified by Cabinet Office Ordinance determined mainly by factors other than Creditworthiness, as referred to in Article 2, paragraph (34) of the Act, shall be as follows:

(i) grades indicating the results of an assessment related to the fluctuation of the interest

rate, value of currency, liquidity and quotations in the Financial Instruments Market, and any other indicators;

(ii) grades indicating the results of an assessment of the capability of the issuer of Securities in performing the management of assets or any other business similar thereto;

(iii) grades indicating the results of an assessment of the capability in performing businesses related to the management and collection of claims;

(iv) grades indicating the results of an assessment of the adequacy of the operation of a trust business, such as capability for management of trust properties; and

(v) in addition to what is listed in the preceding items, grades indicating the results of an assessment mainly determined by matters other than the credit status.

Article 25 (Acts Excluded from Definition of Credit Rating Business)

The acts as specified by Cabinet Office Ordinance, referred to in Article 2, paragraph (35) of the Act shall be as follows:

(i) an act to determine a Credit Rating in response to a request from a rating stakeholder (meaning a rating stakeholder as defined in Article 66-33, paragraph (2) of the Act) and any other person, and to provide the Credit Rating only to such rating stakeholder or such other person (limited to the case where there is no potential risk of such rating stakeholder or such other person providing such Credit Rating for any third party or making them available to the public); and

(ii) an act to provide or making available to the public a grade by using symbols or figures (including texts or characters as set forth in paragraph (2) of the preceding Article), the results of an assessment of the credit status of a juridical person (including a juridical person as set forth in item (i) or (ii), paragraph (1) of the preceding Article; and limited to a juridical person which falls under the category of a Small and Medium-sized Enterprise Operator as listed in the items of paragraph (1) of Article 2 of the Small and Medium-sized Enterprise Basic Act (Act No. 154 of 1963) and which are persons not required to obtain an audit certification pursuant to the provision of Article 193-2, paragraph (1) or (2) of the Act or any other persons which also falls under the scope specified and disclosed in advance as persons similar thereto) derived primarily based on objective indicators of the credit status of said juridical person and in accordance with a computation given in advance.

Annex 4c

(Translations are not official, but for reference purposes only.)

Cabinet Office Ordinance on Financial Instruments Business, etc. (Ordinance No. 52 of 2007) related to Regulation on Credit Rating Agencies

Article 1 (Definitions)

(1) As used in this Cabinet Office Ordinance, the terms "Securities," "Public Offering of Securities," "Private Placement of Securities," "Secondary Distribution of Securities," "Issuer," "Underwriter," "Financial Instruments Business," "Financial Instruments Business Operator," "Prospectus," "Financial Instruments Intermediary Service," "Financial Instruments Intermediary Service Provider," "Authorized Financial Instruments Firms Association," "Financial Instruments Market," "Financial Instruments Exchange", "Financial Instruments Exchange Market," "Trading Participant," "Derivative Transactions," "Market Transactions of Derivatives," "Over-the-Counter Transactions of Derivatives," "Foreign Market Derivatives Transactions," "Financial Instruments," "Financial Indicator," "Foreign Financial Instruments Exchange," "Brokerage for Clearing of Securities, etc.," "Financial Instruments Clearing Organization," "Securities Finance Company," "Professional Investor," "Credit Rating," "Credit Rating Business" or "Credit Rating Agency" shall respectively mean the Securities, Public Offering of Securities, Private Placement of Securities, Secondary Distribution of Securities, Issuer, Underwriter, Financial Instruments Business, Financial Instruments Business Operator, Prospectus, Financial Instruments Intermediary Service, Financial Instruments Intermediary Service Provider, Authorized Financial Instruments Firms Association, Financial Instruments Market, Financial Instruments Exchange, Financial Instruments Exchange Market, Trading Participant, Derivative Transactions, Market Transactions of Derivatives, Over-the-Counter Transactions of Derivatives, Foreign Market Derivatives Transactions, Financial Instruments, Financial Indicator, Foreign Financial Instruments Exchange, Brokerage for Clearing of Securities, etc., Financial Instruments Clearing Organization, Securities Finance Company, Professional Investor, Credit Rating, Credit Rating Business or Credit Rating Agency as defined in Article 2 of the Financial Instruments and Exchange Act (hereinafter referred to as the "Act").

(2) – (4) (omitted)

Article 2 (Attachment of Japanese Translation)

In cases where, due to any special circumstance, there is any document to be submitted to the Commissioner of Financial Services Agency, Director-General of a Local Finance Bureau or Director-General of the Fukuoka Local Finance Branch Bureau (hereinafter referred to as the "Commissioner of Financial Services Agency or Other Official") pursuant to the provisions of the Act (limited to Chapter III through Chapter III-III and Article 188 of the Act (limited to the provisions pertaining to Financial Instruments Business Operators, etc., Financial Instruments Intermediary Service Providers or Credit Rating Agencies; the

same shall apply in the following Article)), the Cabinet Order (limited to Chapters IV through IV-III; the same shall apply in the following Article) or this Cabinet Office Ordinance (excluding Article 236 and Articles 239 to 243 inclusive) that cannot be prepared in Japanese, a Japanese translation thereof shall be attached thereto; provided, however, that if the documents to be submitted is the articles of incorporation, or the minutes of a shareholders meeting or a Board of Officers, etc. (meaning a Board of Officers, etc. as prescribed in Article 221, item (i)) prepared in English, attaching a Japanese translation of the outline thereof shall be sufficient.

Article 116-2 (Credit Ratings less likely to Result in Insufficient Protection of Investors)

The acts as specified by Cabinet Office Ordinance, as referred to in Article 38, item (iii) of the Act, shall be as follows:

(i) a Credit Rating on the assessment regarding the credit status of the Underlying Assets (meaning Underlying Assets as set forth in Article 295, paragraph (3), item (ii)) of the Asset Securitization Products (meaning Asset Securitization Products as set forth in item (i) of that paragraph; hereinafter the same shall apply in this item) for which the Contract for Financial Instruments Transaction was concluded (excluding a Credit Rating which is deemed to be substantially a Credit Rating on the assessment of the credit status regarding said Asset Securitization Products); and

(ii) In addition to what is provided for in the preceding item, a Credit Rating whose prime object is the assessment regarding the credit status of Securities other than those pertaining to the Contract for Financial Instruments Transaction or the credit status of any party other than the Issuer of Securities pertaining to said Contract for Financial Instruments Transaction (excluding a Credit Rating which is deemed to be substantially the Credit Rating for the assessment of the credit status of said Securities pertaining to said Contracts for Financial Instruments Transaction or the said Issuer of said Securities).

Article 116-3 (Significance of Registration as Credit Rating Agency and Other Matters)

The matters as specified by Cabinet Office Ordinance, as referred to in Article 38, item (iii) of the Act shall be as follows:

(i) the significance of a registration under Article 66-27 of the Act;

(ii) the following information regarding the person who has determined the Credit Rating:

(a) the trade name or name;

(b) in cases where the person is a juridical person (including an organization without juridical personality for which the representative person or administrator has been designated), the names of the Officers (in cases of an organization without juridical personality for which the representative person or administrator has been designated, the name of such representative person or administrator); and

(c) the name and location of the head office or any other principal business office or offices.

(iii) an outline of the policies and methods adopted by the person who has determined a Credit Rating in determining such Credit Rating; and

(iv) the assumptions, significance and limitations of the Credit Rating.

Chapter IV Credit Rating Agency

Section 1 General Provisions

Article 295 (Definitions)

(1) In this Chapter (excluding Article 295, paragraph (3), items (i) and (iii), Article 299, item (ixl), Article 300, paragraph (1), item (ix), Article 306, paragraph (1), item (xv), Article 307, paragraph (1), item (i), Article 309, item (iii), Article 310, Article 313, paragraph (2), item (ii) and Article 318, item (ii), sub-item (b)3.), the meanings of the terms listed in the following items shall be as prescribed respectively in those items:

(i) juridical person: meaning a juridical person as set forth in Article 66-27 of the Act; and

(ii) Officer: meaning an Officer as set forth in Article 66-28, paragraph (1), item (ii) of the Act.

(2) In this Chapter, the meanings of the terms listed in the following items shall be as prescribed respectively in those items:

(i) Rating Stakeholder: meaning a Rating Stakeholder as set forth in Article 66-33, paragraph (2) of the Act;

(ii) Rating Policy, etc.: meaning a Rating Policy, etc. as set forth in Article 66-36, paragraph (1) of the Act; and

(iii) Subsidiary Juridical Person: meaning a Subsidiary Juridical Person as set forth in Article 66-45, paragraph (2) of the Act.

(3) In this Chapter, the meanings of the terms listed in the following items shall be as prescribed respectively in those items:

(i) Asset Securitization Products: meaning Securities as set forth in Article 2, paragraph (1) of the Act (excluding Securities as set forth in item (i), item (ii), item (vi), item (vii), items (ix) to (xi) inclusive, item (xvi), item (xvii) (limited to Securities which have the natures of securities or certificates as specified in item (i), item (ii), item (vi), item (vii), item (ix) or item (xvi) of that paragraph; hereinafter the same shall apply in this item), item (xix), item (xx) (limited to Securities which indicate the rights regarding securities or certificates as specified in item (i), item (ii), item (vi), item (vii), items (ix) to (xi) inclusive, item (xvi), item (xvii) or item (xix) of that paragraph) and item (xxi) of that paragraph (hereinafter referred to as "Excluded Securities" in this item); and including the rights which are regarded as Securities pursuant to the provision of paragraph (2) of that Article (excluding the rights pertaining to the Excluded Securities and also excluding the rights as listed in items (iii) to (vi) inclusive of that paragraph); the same shall apply in Article 307, paragraph (3)) or claim pertaining to a monetary loan, which satisfy any of therequirements listed in the following items (a) to (e) inclusive (excluding those which

do not satisfy the requirements listed in the following items (f) to (h) inclusive):

(a) Securities or claims which satisfy all of the following requirements:

1. that there exist monetary claims or any other assets (hereinafter referred to as the "Underlying Assets" in this item) to be directly or indirectly transferred (including the acquisition) from the owner thereof to a juridical person (referred to as a "Special Purpose Juridical Person" in this sub-item (a)2., sub-item (c), and Article 307, paragraph (2), item (iii)) incorporated or operated for the purpose of the issuance of such Securities or the borrowing of such money (limited to a borrowing pertaining to the aforementioned money; hereinafter the same shall apply in this item); and

2. that the Special Purpose Juridical Person issues such Securities or takes out such monetary loan, and that it allocates money derived from the management, investment or disposition of the Underlying Assets as referred to in 1., to satisfy the obligations pertaining to such Securities or monetary loans (including Securities to be issued for the purpose of refinancing said Securities or loans; and also including loans taken out for the purpose of such refinancing).

(b) Securities or claims which satisfy any of the following requirements:

1. that the trust has been created on Underlying Assets in accordance with the method specified in Article 3, items (i) or (iii) of the Trust Act (including the method under the laws and regulations of foreign states, which is similar to those: hereinafter the same shall apply in 2. and item (d)2.), and that money derived from the management, investment or disposition of said Underlying Assets are allocated to satisfy the obligations pertaining to Trust Beneficiary Certificates, etc. (meaning Trust Beneficiary Certificates as defined in Article 1, item (iv) of the Cabinet Office Ordinance on the Disclosure of Information, etc. on Regulated Securities (Ordinance of the Ministry of Finance No. 22 of 1993); Trust Corporate Bond Certificate as defined in item (iv)-2 of that Article; Foreign Loan Trust Beneficiary Certificate as defined in item (iv)-4 of that Article; and rights as referred to in Article 2, paragraph (2), items (i) and (ii) of the Act; hereinafter the same shall apply in (b) and item (d)2.) of the trust, or the obligations pertaining to monetary loans related to said trust (including Trust Beneficiary Certificates, etc. issued for the purpose of refinancing said Trust Beneficiary Certificates, etc. or said loan; and also including loans taken out for the purpose of said refinancing); or

2. that the trust has been created in accordance with the method specified in Article 3, items (i) or (iii) of the Trust Act, and that Underlying Assets have been acquired by the money derived from said trust, the issuance of Trust Corporate Bond Certificate pertaining to the said trust (meaning Trust Corporate Bond Certificate as defined in Article 1, item (iv)-2 of the Cabinet Office Ordinance on the Disclosure of Information, etc. on Regulated Securities; hereinafter the same shall apply in item (d)2.) or the obligations pertaining to monetary loans related to said trust, and that money derived from the management or disposition of said Underlying Assets are allocated to satisfy the obligations pertaining to Trust Beneficiary Certificates, etc. of the trust, or the

obligations pertaining to monetary loans related to said trust (including Trust Beneficiary Certificates, etc. issued for the purpose of refinancing said Trust Beneficiary Certificates, etc. or said loan; and also including loans taken out for the purpose of said refinancing);

(c) Securities or claims which satisfy all of the following requirements:

1. that the contracts have been concluded, whereby the risk of loss arising from the change of the credit status of the Underlying Assets, in whole or part, will be transferred from a third party to the Special Purpose Juridical Person; and

2. that the Special Purpose Juridical Person issues such Securities or takes out such monetary loan, and that it allocates money derived from the management, investment or disposition of money or any other assets derived from the contract as referred to in 1., the issuance of said Securities or said borrowing to satisfy the obligations pertaining to said Securities or monetary loan (including Securities to be issued for the purpose of refinancing said Securities or monetary loan; and also including monetary loans taken out for the purpose of said refinancing).

(d) Securities or claims which satisfy all of the following requirements:

1. that the trust has been created in accordance with the method specified in Article 3, items (i) or (iii) of the Trust Act, and that the contracts have been concluded wherein the risk of loss arising from the change of the credit status of the Underlying Assets, in whole or part, will be transferred from a third party to the trustee; and

2. that the money derived from the management, investment or disposition of money and any other assets derived from the contract referred to in 1., said trust, the issuance of the Trust Corporate Bond Certificate pertaining to the Trust or from the monetary loan shall be allocated to satisfy the obligations pertaining to the Trust Beneficiary Certificates, etc. of the trust or monetary loan pertaining to the trust (including Trust Beneficiary Certificates, etc. issued for the purpose of refinancing said Trust Beneficiary Certificates, etc. or said loan; and also including the loans taken out for the purpose of such refinancing).

(e) in addition to the requirements listed in items (a) to (d) inclusive above, requirements of a similar nature as designated by the Commissioner of the Financial Services Agency;

(f) such securities or claim pertaining to a monetary loan (hereinafter referred to as "Said Securities, etc." in this sub-item (f) and (g)), whose Underlying Assets are securities (meaning Securities as set forth in Article 2, paragraph (1) of the Act or the rights which are regarded as Securities pursuant to the provision of paragraph (2) of that Article) issued by a single issuer or claims against a single obligor (limited to the cases where the credit status of Underlying Assets is deemed to have substantially the same credit status of Said Securities, etc.)

(g) Said Securities, etc., falling under the case where a Specified Commitment Line Contract as specified by Article 2 of the Act on Specified Commitment Line Contract (Act No. 4 of 1999)(including similar contract concluded under the laws and

regulations of foreign states) has been concluded between the Special Purpose Juridical Person as referred to in sub-item (a)1. and sub-item (c)1. and a single person and the case where said Special Purpose Juridical Person has an option to effect a loan for consumption based on the contract to satisfy the obligations pertaining to Said Securities, etc. (limited to the cases where the credit status of said person is deemed to have substantially the same credit status of Said Securities, etc.); and

(h) those designated by the Commissioner of the Financial Services Agency.

(ii) Underlying Assets: meaning Underlying Assets as referred to in sub-item (a)1., sub-item (b)1.and 2., sub-item (c)1. and sub-item (d)1. of the preceding item;

(iii) Rating Analyst: meaning a person who, prior to determining a Credit Rating, performs an analysis of the credit status of financial instruments or juridical persons (including a juridical person as referred to in Article 24, paragraph (1) of the Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act; the same shall apply in Article 299, item (xxxix), Article 300, paragraph (1), item (ix) , Article 306, paragraph (1), item (xv), Article 307, paragraph (1), item (i), Article 309, item (iii), Article 310, Article 313, paragraph (2), item (ii) and Article 318, item (ii), sub-item (b)3.) as well as an assessment based on such analysis, utilizing their expert knowledge and skills;

(iv) Lead Rating Analyst: meaning a single Lead Rating Analyst participating in the process of determining a Credit Rating;

(v) Person in Charge of Rating: meaning a Rating Analyst participating in the process of determining a Credit Rating for the matters in which Rating Stakeholders have interests (meaning the matters specified in Article 309; hereinafter the same shall apply in this Chapter), and a member of the council which makes the final decision as a Credit Rating Agency for the determination of the Credit Rating;

(vi) Compliance With Laws and Regulations, etc.: meaning compliance with Laws and Regulations, etc. (which collectively means laws and regulations (including laws and regulations of foreign states), the disposition of administrative agencies issued under the laws and regulations (including dispositions of a similar nature issued under the laws and regulations of foreign states) or any other regulations including articles of incorporation; the same shall apply in Article 299, item (x) and Article 306, paragraph (1), item (v), sub-item (c)), in terms of the operation of Credit Rating Business;

(vii) Chief Compliance Officer: meaning a person in charge of implementing measures so as to ensure Compliance With Laws and Regulations, etc.;

(viii) Credit Rating Activity: meaning an activity for determining a Credit Rating, or providing them to someone or making them available to the public (limited to those pertaining to Credit Rating Business);

(ix) Conflict of Interests: meaning an act to undermine the interests of investors, in an attempt to benefit itself or Rating Stakeholders and any other persons; and

(x) Associated Juridical Person: meaning the Subsidiary Juridical Person of a juridical person, another juridical person which has the juridical person as its Subsidiary

Juridical Person, or a Subsidiary Juridical Person of another juridical person which has the juridical person as its Subsidiary Juridical Person (excluding said juridical person), which performs Credit Rating Activities in the course of the trade.

Article 296 (Application for Registration)

A person who intends to obtain a registration under Article 66-27 of the Act shall submit to the Commissioner of the Financial Services Agency a written application for registration under Article 66-28, paragraph (1) of the Act prepared in accordance with Appended Form No. 27, attaching a copy thereof as well as documents or Electromagnetic Records to be attached thereto pursuant to the provision of paragraph (2) or (3) of that Article.

Article 297 (Person Equivalent to Representative Person in Japan of Foreign Juridical Person)

A person as specified by Cabinet Office Ordinance, as referred to in Article 66-28, paragraph (1) of the Act, shall be a person who, as a representative of a foreign juridical person (limited to a foreign juridical person which, pursuant to the provision of the proviso to Article 66-30, paragraph (2) of the Act, is not required to have its business office or any other office in Japan), acts as a liaison and coordinator with the Commissioner of the Financial Services Agency (limited to a person who is capable of providing an account of the status of its Compliance With Laws and Regulations, etc.).

Article 298 (Matters to be Included in Written Application for Registration)

The matters as specified by Cabinet Office Ordinance, referred to in Article 66-28, paragraph (1), item (v) of the Act, shall be as follows:

(i) the name of the Representative Person in Japan as set forth in Article 66-28, paragraph (1) of the Act or the person as set forth in the preceding Article of the registration applicant (limited to a foreign juridical person);

(ii) the following matters concerning another registration applicant or Credit Rating Agency, which falls under the registration applicant's Associated Juridical Person and which, jointly with the registration applicant, performs Credit Rating Activities:

(a) the trade name or name;

(b) the location of its head office, or of its principal business office or principal office;

(iii) the following matters concerning the Associated Juridical Person of the registration applicant (excluding the another registration applicant or Credit Rating Agency, which falls under the registration applicant's Associated Juridical Person and which, jointly with the registration applicant, performs Credit Rating Activities):

(a) the trade name or name;

(b) the location of its head office, or of its principal business office or principal office;

(iv) the following matters concerning the registration applicant (limited to a foreign juridical person):

(a) the name of the state where the head office, the principal business office or principal

office is located;

(b) in cases where the registration applicant is subject to the supervision of any administrative organ of a foreign state or any other agency equivalent thereto, which takes charge of the supervision of parties carrying out businesses equivalent to the Credit Rating Business in the state referred to in item (a) (hereinafter referred to as an "Foreign Administrative Organ, etc." in this Chapter), to that effect and the name and location of said Foreign Administrative Organ, etc.; and

(v) the names of the Chief Compliance Officer, a person in charge of supervising Rating Analysts in the process of determining a Credit Rating, and members of Supervisory Committee (meaning the Supervisory Committee as set forth in Article 306, paragraph (1) item (xvii); hereafter the the same shall apply in Article 299, item (xxxv), Article 300, paragraph (1), items (iv) and (v) and Article 304, item (vi)).

Article 299 (Contents and Methods of Business)

The matters specified by Cabinet Office Ordinance, as referred to in Article 66-28, paragraph (2), item (ii) of the Act shall be as follows:

(i) the fundamental principles governing the business operation;

(ii) the method of execution of the business;

(iii) the method of allocation of the business;

(iv) the details of Credit Rating Activities performed in the course of trade, and the categories of the objects of the Credit Ratings pertaining to said activities;

(v) the details of the measures to be implemented so that a Person in Charge of Rating, as a party independent of a Rating Stakeholder, fairly and faithfully carries out the business, in cases where such Rating Stakeholder consecutively participates in the processes of determining Credit Ratings for the matter in which the same Rating Stakeholder has an interest;

(vi) the policies for the recruitment of employees (excluding Rating Analysts);

(vii) the details of the measures to be implemented for establishing systems to secure the adequacy of the operation of the Credit Rating Business (meaning the measures as set forth in Article 306, paragraph (1), item (iv));

(viii) the policies and procedures for Compliance with Laws and Regulations, etc.;

(ix) policies which clearly define the roles and responsibilities for Compliance With Laws and Regulations, etc., such as the appointment of a Chief Compliance Officer;

(x) the details of the measures for handling the case where an employee is found to have acted in violation of laws and regulations, etc.;

(xi) policies on the recruitment and training of Rating Analysts;

(xii) the assignment of duties among Rating Analysts;

(xiii) the method of the appointment of members of the council which makes the final decision for determining a Credit Rating, and the methods for the decision-making of such council;

(xiv) the method of the appointment of a person responsible for supervising Rating

Analysts in the process of determining Credit Ratings;

(xv) the details of the measures to be implemented so that the information used for determining a Credit Rating is of sufficient quality;

(xvi) the details of measures to be implemented so as to refrain from determining a Credit Rating, in cases where it is unable to retain sufficient staff with the expert knowledge and skills required for determining a Credit Rating, or in cases where it is unable to secure a sufficient quality of the information it uses for determining a Credit Rating;

(xvii) the details of the functions to properly verify the appropriateness and effectiveness of a Rating Determination Policy, etc. (meaning a Rating Determination Policy, etc. as set forth in Article 313, paragraph (1), item (i); the same shall apply in the following item, item (xxxvi), Article 306, paragraph (1), item (vi), Article 311 and Article 312, item (i));

(xviii) the details of the measures to be implemented in cases of any material amendment to a Rating Determination Policy, etc., if any, so as to announce, without delay, the scope of Credit Ratings already determined in accordance with the former Rating Determination Policy, etc. but which require further consideration as to the necessity of being updated in accordance with the amended Rating Determination Policy, etc. and the period of time required for such updating, as well as to update Credit Ratings within such period of time;

(xix) the details of the measures to be implemented to verify the ability of adequately determining a Credit Rating, in cases where the object of the Credit Rating is the assessment of the credit status of Asset Securitization Products (limited to the cases where the design of said Asset Securitization Products substantially deviates from the Asset Securitization Products which were determined Credit Ratings in the past);

(xx) the details of the measures to be implemented so as to enable implementation of the verification and updating of a Credit Rating already determined, in an appropriate manner and on an ongoing basis;

(xxi) the types of Specified Acts (meaning Specified Acts as set forth in Article 306, paragraph (1), item (vii), sub-item (a); the same shall apply in item (xxvii)) and the outline of the Measures for Avoiding Conflicts of Interest (meaning Measures for Avoiding Conflicts of Interest as set forth in sub-item (a) of item (vii) of that paragraph; the same shall apply in item (xxvii));

(xxii) the details of the measures to be implemented in order to prevent the Person in Charge of Rating from conducting the Sale and Purchase or Other Transactions of Securities, etc. which may entail any Conflicts of Interest;

(xxiii) the details of the measures to be implemented so as to refrain from providing to someone a Credit Rating of any Matter in Which Rating Stakeholders Have Interests or making them available to the public, in cases where the registration applicant or one of its Officers or employees has a close relationship with any Rating Stakeholders as set forth in Article 308;

(xxiv) the details of the measures to be implemented to ensure that the interests of

investors would not be adversely affected in the process of determining a Credit Rating of any Matter in Which Rating Stakeholders Have Interests, in cases where there may arise any Conflict of Interests between the registration applicant and the Rating Stakeholders;

(xxv) the details of the measures to be implemented to prevent Person in Charge of Ratings from making any approach in an attempt to assume the position of an Officer or any other position equivalent thereto of the Rating Stakeholder;

(xxvi) the details of the measures to be implemented so as to verify the appropriateness of a Credit Rating of any Matter in Which Rating Stakeholder Have Interests, in cases where any Rating Analyst who no longer assume the position of Officer or employee of registration applicant assumes the position of an Officer or any other position equivalent thereto of the Rating Stakeholder;

(xxvii) the details of the measures to be implemented for the announcement of types of Specified Acts and an outline of Measures for Avoiding Conflicts of Interest in an appropriate manner;

(xxviii) the details of the measures to be implemented so that activities pertaining to Ancillary Businesses (meaning businesses excluding Credit Rating Service but are ancillary to Credit Rating Activities; hereinafter the same shall apply in this Chapter) and any Other Lines of Business (meaning businesses excluding Credit Rating Business and also excluding the Ancillary Businesses; hereinafter the same shall apply in this Chapter) would not unreasonably affect the Credit Rating Activities;

(xxiv) the details of the measures to be implemented 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 Asset Securitization Products;

(xxx) policies for the determination of the Remuneration, etc. (meaning any remuneration, bonus or any other property benefit payable by the registration applicant as a consideration for the performance of duties; the same shall apply in the following item) of Officers and employees of the registration applicant;

(xxxi) the details of the measures to be implemented to ensure that the policy for the determination of the Remuneration, etc. of Officers and employees of the registration applicant would not adversely affect the performance of its Credit Rating Business in a fair and adequate manner;

(xxxii) the details of the measures to be implemented so as to prevent the Person in Charge of Ratings from being involved in the negotiation process concerning the determination of the Rating Fee (meaning the value of the money or any other property which has been or will be paid to the registration applicant as a consideration for determining a Credit Rating) for the Credit Rating;

(xxxiii) the details of the measures to be implemented so as to properly manage information which may come to the attention in the course of the performance of the Credit Rating Business, as well as to properly maintain the confidentiality thereof;

(xxxiv) the details of the measures to be implemented so as to appropriately and swiftly address any complaints raised against the registration applicant;

(xxxv) the operational policies of the Supervisory Committee and the method of the appointment of the members thereof; and

(xxxvi) the following matters concerning the Rating Determination Policy, etc.:

(a) the categories of the objects of the Credit Rating and the matters which serve as the assumptions for the assessment of a credit status in accordance with the items so categorized, and the criteria to be used for setting grades indicating the results of the assessment of the credit status;

(b) the policy and method which enable a Rating Stakeholder, in advance of providing to someone or making available to the public the determined Credit Rating, to verify whether there was any factual misperception as to the principal information used by the registration applicant in determining the Credit Rating; and

(c) the policy and method of determining Credit Ratings, in cases of determining a Credit Rating without a solicitation from any Rating Stakeholder;

(xxxvii) the Rating Provision Policy, etc. (meaning the Rating Provision Policy, etc. as set forth in Article 313, paragraph (1), item (ii));

(xxxviii) the details of the measures to be implemented so as to secure compliance with the Rating Policy, etc. by Officers and employees;

(xxxix) the details of the measures to be implemented to prevent any false representation of the general features of the assessment results of the credit status of any financial instruments or juridical persons, or to prevent any representation which may lead to any misperception as to any material information:

(xl) the details of the measures to be implemented to prevent any act pertaining to Ancillary Businesses from being misperceived as any act pertaining to the Credit Rating Business, in cases where any act pertaining to Ancillary Businesses is to be conducted; and

(xli) the code of conduct required to be complied with by the registration applicant as well as its Officers and employees.

Article 300 (Documents to be Attached to Written Application for Registration)

The documents specified by Cabinet Office Ordinance, referred to in Article 66-28, paragraph (2), item (iv) of the Act, shall be as follows:

(i) the documents describing the business execution system, such as its personnel structures and the operational control systems pertaining to the business;

(ii) the following documents concerning Officers (including those who are found to have the same or a higher authority over a juridical person as directors, executive officers or any persons holding positions equivalent thereto, irrespective of their job title such as advisor, consultant or others; hereinafter the same shall apply in this item, Article 303 and Article 304, item (ii)):

(a) the resumés of the Officers (in cases where an Officer is a juridical person, the

document describing the background of said Officer);

(b) the extracts from the certificates of residence of the Officers (in cases where the Officer is a juridical person, its certificate of registered matters; or in cases where the Officer is a foreign national, his/her certificate of matters registered in the alien registration record), or any other document in lieu thereof;

(c) the certificate issued by a public agency evidencing that none of the Officers falls under Article 29-4, paragraph (1), item (ii), sub-item (a) or (b) of the Act, or any other document in lieu thereof;

(d) the document in which each of the Officers pledges that he/she does not fall under any of Article 29-4, paragraph (1), item (ii), sub-items (c) to (g) inclusive of the Act;

(iii) the following documents concerning the Representative Person in Japan of the registration applicant (limited to a foreign juridical person), as referred to in Article 66-28, paragraph (1) of the Act, or concerning a person as referred to in Article 297:

(a) resumé;

(b) extract from the certificate of residence (in cases where such person is a foreign national, his/her certificate of the matters registered in the alien registration record), or any other document in lieu thereof;

(iv) the following documents concerning the Chief Compliance Officer, a person in charge of supervising Rating Analysts in the process of determining a Credit Rating and members of the Supervisory Committee;

(a) resumés;

(b) extracts from the certificates of residence (in cases where such person is a foreign national, his/her certificate of the matters registered in the alien registration record), or any other document in lieu thereof;

(v) a document describing the reasons based on which the Independent Members (meaning Independent Members as set forth in Article 306, paragraph (1), item (xvii), sub-item (a)) of the Supervisory Committee are deemed to be independent;

(vi) a document describing the outline of the share-capital relationship, personnel relationship, and business relationship in the most recent year, as between the registration applicant, and another registration applicant or Credit Rating Agency which falls under the category of an Associated Juridical Person of the registration applicant and which performs Credit Rating Activities jointly with the registration applicant;

(vii) a document describing the following conditions of an Associated Juridical Person of the registration applicant (excluding another registration applicant or Credit Rating Agency which falls under the registration applicant's Associated Juridical Person and performs Credit Rating Activities jointly with the registration applicant, as set forth in the preceding item):

(a) an outline of the share-capital relationship, personnel relationship, and business relationship in the most recent one year, as between the registration applicant and its Associated Juridical Person;

(b) the name of the state where the head office, principal business office or principal

office of the Associated Juridical Person (limited to a foreign juridical person) of the registration applicant is located; and, in cases where it is subject to supervision by any Foreign Administrative Organ, etc. in that state, to that effect, and the name and location of said Foreign Administrative Organ, etc.;

(viii) the most recent balance sheet (including notes related thereto; the same shall apply in the following paragraph) and the most recent profit and loss statement (including notes related thereto; the same shall apply in that paragraph); and

(ix) in cases where the registration applicant possesses any statistical information or any other information on the transition of a credit status (limited to the case where the object of the Credit Rating is the assessment of such credit status) of financial instruments or juridical persons, a document describing such information.

(2) In cases where the documents specified in item (viii) of the preceding paragraph are to be attached, and where the balance sheet or profit and loss statement has been prepared by means of an Electromagnetic Record, the Electromagnetic Record (limited to an Electromagnetic Record as set forth in the following Article) may be attached in lieu of said documents.

(3) In cases where the registration applicant has obtained registration under Article 66-27 of the Act, and where it intends to seek approval as set forth in Article 306, paragraph (2) or (3), it may attach to the written application for registration the document as set forth in paragraph (4) of that Article.

(4) In cases where the registration applicant has obtained registration under Article 66-27 of the Act, and where it intends to seek approval as set forth in Article 306, paragraph (6), it may attach to the written application for registration the document as set forth in paragraph (7) of that Article.

Article 301 (Electromagnetic Records)

(1) An Electromagnetic Record as specified by Cabinet Office Ordinance, and as referred to in Article 66-28, paragraph (3) of the Act, shall be a 90mm flexible magnetic disk cartridge which complies with X6223 of the Japanese Industrial Standards.

(2) Entry onto an Electromagnetic Record as set forth in the preceding paragraph shall be completed in accordance with the following methods:

(i) with regard to the track format, the method designated by the JIS X6225; and

(ii) with regard to volume and file configuration, the method designated by the JIS X0605.

(3) With regard to the Electromagnetic Record set forth in paragraph (1), a document containing the following matters shall be affixed to the label area specified by the JIS X6223:

(i) the trade name or name of the registration applicant; and

(ii) the date of application.

Article 302 (Public Inspection of Registry of Credit Rating Agencies)

The Commissioner of the Financial Services Agency shall keep and make available for

public inspection the registry of Credit Rating Agencies containing information on the Credit Rating Agencies to which he/she has granted registration, at the office of the Financial Services Agency.

Article 303 (Criteria for Examination of Operational Control Systems)

When conducting an examination under Article 66-30, paragraph (1), item (v) of the Act as to whether the registration applicant is a juridical person not found to have established a system necessary for the fair and appropriate performance of the Credit Rating Business, it shall be examined, in addition to the documents describing the matters set forth in Article 299 and the documents listed in Article 300, paragraph (1), whether it is likely that the registration applicant may be have a detrimental effect on the confidence in Credit Rating Business, on the grounds of any Officer or employee having qualities which render them unfit for the operation of the business in light of their careers, relationships with the Organized Crime Group set forth in Article 2, item (ii) of the Act on Prevention of Illegal Acts by Organized Crime Group Members or relationships with the Organized Crime Group Members set forth item (vi) of that Article or any other circumstances.

Article 304 (Notification of Change to Matters Contained in Written Application for Registration)

A Credit Rating Agency which intends to file the notification under Article 66-31, paragraph (1) of the Act shall submit to the Commissioner of the Financial Services Agency a written notification stating the particulars and date of and reason for the change, attaching a document stating the particulars after such change prepared in accordance with Appended Form No. 27, a copy thereof and the documents specified in the following items in accordance with the categories of the cases respectively set forth therein; provided, however, that the documents specified in each of the following items may be filed without delay after submission of the notification, if any unavoidable ground exists:

(i) in cases where there has been any change to the matters specified in Article 66-28, paragraph (1), item (i) of the Act: the certificate of the registered matters containing the particulars so changed, or any other document in lieu thereof;

(ii) in cases where there has been any change to the matters specified in Article 66-28, paragraph (1), item (ii) of the Act, the following documents:

(a) a document stating the business execution system, such as the personnel structure and the organization,etc. related to the business;

(b) the certificate of the registered matters containing the particulars so changed, or any other document in lieu thereof;

(c) the following documents concerning a person who has newly assumed the position of Officer:

1. his/her resumé (in cases where the Officer is a juridical person, the document containing the background of said Officer);

2. extracts from the certificate of residence (in cases where the Officer is a juridical

person, its certificate of registered matters; or in cases where such person is a foreign national, his/her certificate of the matters registered in the alien registration record), or any other document in lieu thereof;

3. the certificate issued by a public agency evidencing that none of the Officers falls under Article 29-4, paragraph (1), item (ii), sub-item (a) or (b) of the Act, or any other document in lieu thereof;

4. the documents in which each of the Officers pledges that he/she does not fall under any of Article 29-4, paragraph (1), item (ii), sub-items (c) to (g) inclusive of the Act;

(iii) in cases where there has been any change to the matter specified in Article 298, item (i): the following documents concerning a person who has newly assumed the position of Representative Person in Japan as set forth in Article 66-28, paragraph (1), or has newly assumed the position of a person set forth in Article 297;

(a) the resumé; and

(b) extracts from the certificate of residence (in cases where such person is a foreign national, his/her certificate of the matters registered in the alien registration record), or any other document in lieu thereof;

(iv) in cases where there has been any change to the matter specified in Article 298, item (ii): a document describing the outline of the share-capital relationship, personnel relationship, and business relationship in the most recent one year as between the Credit Rating Agency and those who have newly become its Associated Juridical Person;

(v) in cases where there has been any change to the matter specified in Article 298, item (iii): a document describing the following matters:

(a) an outline of the share-capital relationship, personnel relationship, and business relationship in the most recent one year, as between the Credit Rating Agency and those who have newly become its Associated Juridical Person;

(b) the name of the state where the head office, principal business office or principal office of those who have newly become the Associated Juridical Person (limited to a foreign juridical person) of the Credit Rating Agency is located; and, in cases where it is subject to supervision by any Foreign Administrative Organ, etc. in that state, to that effect, and the name and location of said Foreign Administrative Organ, etc.;

(vi) in cases where there has been any change to the matter specified in Article 298, item (v): the following documents concerning a person who has newly assumed the position of Chief Compliance Officer, a person in charge of supervising Rating Analysts in the process of determining a Credit Rating, and members of Supervisory Committee:

(a) the resumés; and

(b) extracts from the certificate of residence (in cases where such person is a foreign national, his/her certificate of the matters registered in the alien registration record), or any other document in lieu thereof.

Article 305 (Notification on Change to Contents or Method of Business)

A Credit Rating Agency which intends to file the notification under Article 66-31,

paragraph (3) of the Act shall submit to the Commissioner of the Financial Services Agency a written notification stating the particulars and date of and reason for the change, attaching a document stating the matters listed in the items of Article 299 (limited to those matters whose contents have been changed).

Section 2 Business

Article 306 (Establishment of Operational Control Systems)

(1) The operational control systems required to be established by a Credit Rating Agency pursuant to the provision of Article 66-33, paragraph (1) of the Act shall satisfy the following requirements:

(i) that measures have been implemented so that the Credit Rating Agency shall always maintain a fair and unbiased stance in order to perform its Credit Rating Activities at its sole judgment and responsibility;

(ii) that any of the following measures has been implemented, so that a Person in Charge of Rating, as a party independent from Rating Stakeholders, fairly and faithfully carries out the business, in cases where such Person in Charge of Rating participates consecutively in the processes of determining Credit Ratings of the matters in which the same Rating Stakeholder has an interest;

(a) measures to be implemented so that, in cases where any Lead Rating Analyst participating in the process of determining a Credit Rating had, for five consecutive years, participated in the process of determining a Credit Rating of the matter in which the same Rating Stakeholder has an interest, such Lead Rating Analyst would refrain from participating in the process of determining a Credit Rating of the matter in which the same Rating Stakeholder has an interest for two subsequent years thereafter;

(b) measures to ensure that the final decision as a Credit Rating Agency in determining a Credit Rating shall be made by a resolution of the council; and measures so that one third or more of the total of the council members would not participate consecutively in the processes of determining Credit Ratings for the matter in which the same Rating Stakeholders has an interest (in cases where the object of the Credit Rating is the assessment of the credit status of any subject other than Asset Securitization Products, and where two or more Credit Ratings with the same object were determined in the same business year, such two or more Credit Ratings shall be deemed to be a single Credit Rating);

(iii) that the measures have been implemented, so as not to recruit any person about whom serious questions might be raised as to his/her competency in performing Credit Rating Activities in a fair manner;

(iv) that the measures for establishing the following systems for securing the proper business operation of the Credit Rating Agency have been implemented:

(a) a system to ensure that the Officers will execute their respective duties efficiently;

(b) a system for the preservation and management of information on the execution of

duties by Officers; and

(c) regulations and any other system for management of risk of loss.

(v) that the following measures to secure Compliance With Laws and Regulations, etc. have been implemented:

(a) the formulation of policies and procedures for Compliance With Laws and Regulations, etc.;

(b) the formulation of policies to clearly define responsibilities with regard to Compliance With Laws and Regulations, etc., such as the appointment of a Chief Compliance Officer;

(c) the following measures in relation to handling cases where the act of an employee was found to be in violation of the laws and regulations, etc.:

1. the measures to notify Officers and the Chief Compliance Officer with an account of the act of any employee of a Credit Rating Agency committed in violation of laws and regulations, in cases where any such act has been discovered;

2. the appropriate measures to be implemented by the Officers and Chief Compliance Officer as notified above, so as to prevent the Credit Rating Agency from committing any act which may violate laws and regulations, etc.; and

3. the measures to ensure that the person who has made the notification shall not be treated unfavorably on account of having made such notification;

(vi) that the following measures for the formulation and enforcement of policies on managing the quality of the Credit Rating determining process have been implemented:

(a) the measures to retain sufficient staffs with the expert knowledge and skills which enable them to implement appropriately and smoothly the operation of the Credit Rating Business (in cases where its final decision as a Credit Rating Agency in determining a Credit Rating is to be made by a resolution of the council, the method of the appointment of the council members, the decision-making process of such council, and any other measures so as to ensure that employees can exercise their expert knowledge and skills in an appropriate manner shall also be included);

(b) the measures to ensure that the information used in determining a Credit Rating is of sufficient quality;

(c) the measures to refrain from determining a Credit Rating, in cases where the Credit Rating Agency is unable to secure sufficient staff with expert knowledge and skills for determining a Credit Rating, or in cases where it is unable to secure a sufficient quality of the information it uses for determining a Credit Rating;

(d) the measures to put in place the functions to properly verify the appropriateness and effectiveness of the Rating Determination Policy, etc. (including measures to secure the proper verification of the appropriateness and effectiveness of a Rating Determination Policy, etc. for Asset Securitization Products, in cases of the occurrence of any change to the characteristics of the credit status of the Underlying Assets of said Asset Securitization Products);

(e) the measures to be implemented in cases of any material amendment to the Rating

Determination Policy, etc., if any, so as to announce, without delay, the scope of Credit Ratings already determined in accordance with the former Rating Determination Policy, etc. but which require further consideration as to the necessity of being updated in accordance with the amended Rating Determination Policy, etc. and the period of time required for such updating, as well as to update the Credit Ratings within such period of time;

(f) the measures to verify the ability of the Credit Rating Agency in determining a Credit Rating in an appropriate manner, in cases where the objectof such Credit Rating is the assessment of the credit status of Asset Securitization Products (limited to the cases where the design of said Asset Securitization Products substantially deviates from the Asset Securitization Products to which it determined Credit Ratings in the past);

(g) the measures so that the Credit Rating Agency will be able to implement the verification and updating of a Credit Rating already determined, in an appropriate manner and on an ongoing basis (in cases where it has decided not to implement such verification or updating, measures to announce, without delay, such fact and any other necessary information);

(vii) that the following measures to prevent any Conflicts of Interest which may arise in connection with the Credit Rating Business have been implemented:

(a) the measures to identify Credit Rating Activities which entail any actual or potential Conflicts of Interest (hereinafter referred to as "Specified Acts" in this Chapter) by an appropriate method, and to secure that such acts would not adversely affect the interest of investors (including the following measures; hereinafter referred to as the " Measures for Preventing Conflicts of Interest" in this Chapter):

1. the measures to prevent Person in Charge of Rating from conducting any Sales and Purchases or Other Transactions of Securities, etc. which may entail any Conflicts of Interest;

2. the measures to prevent any Officer or employee who has any potential Conflicts of Interest with a Rating Stakeholder, if any, from participating in the process of determining the Credit Rating of any matter in which said Rating Stakeholder has an interest;

3. the measures to ensure that the Credit Rating Agency would not undermine the interests of investors in the process of determining a Credit Rating of any Matter in Which Rating Stakeholders Have Interests, in cases where there are any potential Conflicts of Interest between the Credit Rating Agency and the relevant Rating Stakeholder, and in cases where any of the following applies:

(i) where the Credit Rating Agency has been furnished with loans (including the guarantee of obligations and the offering of collaterals) by Rating Stakeholder;

(ii) where the holder of five percent or more of the Voting Rights Held by All the Shareholders, etc. of the Credit Rating Agency (excluding voting rights set forth in Article 16) falls under the category of a Rating Stakeholder;

(iii) where the Rating Stakeholder acts as the underwriter of Securities issued by the Credit Rating Agency; or

(iv) where the Credit Rating Agency has been furnished by the Rating Stakeholder with a large amount of money or any other property benefit, as a consideration of services other than the services pertaining to Credit Rating Activities;

4. the measures to prevent Person in Charge of Rating from making any approach in an attempt to assume the position of an Officer or any other position equivalent thereto of the Rating Stakeholder;

5. the measures to be implemented so as to verify the appropriateness of a Credit Rating of any Matter in Which Rating Stakeholder Has an Interest, in cases where any Rating Analyst who no longer assumes the position of Officer or employee of the Credit Rating Agency has assumed the position of an Officer or any other position equivalent thereto of such Rating Stakeholder (limited to the cases where such former Rating Analyst participated in the process of determining such Credit Rating within two years prior to the day when he/she ceased to be an Officer or employee of the Credit Rating Agency);

(b) the measures to announce the types of Specified Acts and the outline of Measures for Preventing Conflicts of Interest, in an appropriate manner;

(viii) that the measures have been implemented so that activities pertaining to Ancillary Businesses or Other Lines of Business would not unreasonably affect the Credit Rating Activities;

(ix) that the following measures have been 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 the announcement of information on the Asset Securitization Products (including the items announced pursuant to sub-item (a) above);

(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 results thereof (meaning the results of the interviews with the Rating Stakeholders in relation to the status of the disclosure of information on the Asset Securitization Products);

(x) that the measures have been implemented so as to formulate the policy for the determination of the Remuneration, etc. (meaning any remuneration, bonus or any other property benefit payable by the Credit Rating Agency as a consideration for the performance of duties; hereinafter the same shall apply in this Chapter) of the Officers or employees of the Credit Rating Agency (limited to a policy which contains the following

details), and so as to ensure that such policy would not adversely affect the performance of the Credit Rating Business in a fair and adequate manner (including measures pertaining to the establishment of a system for periodically performing a review of such policy):

(a) that the amount of the Remuneration, etc. payable to the Chief Compliance Officer would not be affected by the performance outcome of the operation of the Credit Rating Business; and

(b) that the amount of the Remuneration, etc. payable to Person in Charge of Ratings would not be affected by the amount of the Rating Fee (meaning the value of the money or any other property which has been paid or is to be to the Credit Rating Agency as a consideration for determining a Credit Rating; hereinafter the same shall apply in this Chapter) for the Credit Rating.

(xi) that the measures have been implemented, so as to prevent the Person in Charge of Ratings from participating in the negotiation process for determining the Rating Fee for the Credit Rating;

(xii) that the following measures have been implemented, so as to properly manage information which may come to the attention in the course of the performance of the Credit Rating Business, as well as to properly maintain the confidentiality thereof;

(a) the measures to ensure that any information or secrecy which may come to the attention in the course of performance of the Credit Rating Business would not be used for any other purpose than the purpose deemed necessary for implementing the Credit Rating Business in a fair and adequate manner;

(b) the measures to prevent the leakage of secrecy, by means of identifying the scope of such secret and the scope of persons who may obtain such secrecy in the course of their business, and specifying the method of the management of such secrecy;

(xiii) that the measures have been implemented, so as to appropriately and swiftly address the complaints raised against the Credit Rating Agency (including measures concerning the establishment of a system for reporting such complaints to Officers of the Credit Rating Agency);

(xiv) that the measures for the performance of the Credit Rating Business in accordance with the Rating Policy, etc. (including measures pertaining to training of Rating Analysts) have been implemented;

(xv) that the measures have been implemented, so as to prevent the false representation of the general features of the assessment results of the credit status of any financial instruments or juridical persons, or to prevent any representation which may lead to any misperception as to any material information;

(xvi) that the measures have been implemented, so as to prevent any act pertaining to an Ancillary Business from being misperceived as an act pertaining to the Credit Rating Business, in cases where any act pertaining to an Ancillary Businesses is to be conducted;

(xvii) that the measures for organizing a committee which satisfies all of the following

requirements (hereinafter referred to as the "Supervisory Committee" in this Chapter) have been implemented, so as to ensure implementation of the measures as listed in each of the preceding items in an appropriate manner:

(a) that one-third or more of the committee members (two or more committee members, in cases where the number of committee members is three or less) are persons not falling under the category of Officer (excluding an auditoror any other position equivalent thereto) or employee (hereinafter referred to as the "Relevant Officers and Employees, etc." in this item (a)) of the Credit Rating Agency, its Subsidiary Juridical Person, any other juridical person which holds such Credit Rating Agency as its Subsidiary Juridical Person or any Subsidiary Juridical Person of any other juridical person which holds such Credit Rating Agency as its Subsidiary Juridical Person (excluding such Credit Rating Agency), and are persons not having assumed the positions of the Relevant Officers and Employees, etc. within the past five years (such committee member shall be hereinafter referred to as the "Independent Member" in this Chapter);

(b) that the majority of the committee members have expert knowledge related to finance;

(c) that the amount of the Remuneration, etc. of the Independent Members shall not be affected by the performance outcome of the Credit Rating Business of the Credit Rating Agency;

(d) that, during his/her respective tenures, the Independent Member will not be dismissed in opposition to his/her intension, except in the cases where he/she has committed any wrongful act, where he/she is found to have committed any breach of his/her obligations in the course of his/her duties, or where so required under the laws and regulations;

(e) that the opinions of the Independent Members shall be periodically submitted to the Supervisory Committee.

(2) The provision of item (ii) of the preceding paragraph shall not apply in the case where, taking into account the number of Officers and employees of the Credit Rating Agency, the nature, size, and complexity of the Credit Rating Business and any other circumstances, the Credit Rating Agency is found to have difficulty in complying with said provision, and where it is found that implementation of any alternative measures would enable its Officers and employees to carry out its business independently from the Rating Stakeholder and in a fair and faithful manner, provided that approval from the Commissioner of the Financial Services Agency shall be obtained.

(3) The provision of item (xvii) of paragraph (1) shall not apply in the case where, taking into account the number of Officers and employees of the Credit Rating Agency, the nature, size, and complexity of the Credit Rating Business and other circumstances, the Credit Rating Agency is found to have difficulty in complying with said provision, and where it is found that implementation of any alternative measures would enable the Credit Rating Agency to implement properly the measures listed in the items of that paragraph (excluding item (xvii)), provided that approval from the Commissioner of the

Financial Services Agency shall be obtained.

(4) In cases where the Credit Rating Agency intends to obtain an approval pursuant to the provisions of preceding two paragraphs, it shall submit to the Commissioner of the Financial Services Agency a written application for approval, attaching thereto the following documents:

(i) a written statement of reasons;

(ii) a document describing the number of Officers and employees;

(iii) a document describing the nature, size, complexity and any other circumstances of the Credit Rating Business;

(iv) a document describing the details of alternative measures; and

(v) a document containing any other matters which would serve as reference information.

(5) In cases where two or more Credit Rating Agencies (limited to the cases where said two or more Credit Rating Agencies are Associated Juridical Persons, and where they share the same Representative Persons in Japan or a person as set forth in Article 297) are to jointly carry out Credit Rating Activities in the course of trade, said two or more Credit Rating Agencies may jointly establish their operational control systems.

(6) The provision of paragraph (1) (limited to item (ii), item(iv), item (vii), sub-item (a)3.to 5. inclusive, item(ix) and item (xvii), and excluding the provisions pertaining to business office or office located in Japan)) shall not apply to cases where the Credit Rating Agencies (limited to a foreign juridical person; hereinafter the same shall apply in this paragraph and the following paragraph) are deemed to perform their business fairly and adequately by taking other alternative measures and the said Credit Rating Agencies are subject to appropriate supervision by the Foreign Administrative Organ, etc. on the proper functioning of such alternative measures for the fair and adequate implementation of business, provided that approval from the Commissioner of the Financial Services Agency shall be obtained.

(7) In cases where the Credit Rating Agency intends to obtain an approval pursuant to the preceding paragraph, it shall submit to the Commissioner of the Financial Services Agency a written application for approval, attaching thereto the following documents:

(i) a written statement of reasons;

(ii) a document describing the details of other alternative measures

(iii) a document proving that the Credit Rating Agency is subject to the appropriate supervision by the Foreign Administrative Organ, etc.

(iv) a document containing any other matters that will be helpful; and

(v) a legal opinion stating that the matters related to laws and regulations written in the documents of each of the preceding items are true and accurate, which shall be prepared by legal profession, as well as a copy of the relevant provisions of the applicable laws and regulations referred in said legal opinion

(8) The Commissioner of the Financial Services Agency may impose conditions or time limit on the approval for paragraph (2), paragraph (3) or paragraph (6), change them or rescind said approval.

Article 307 (Rating Stakeholders)

(1) The persons as specified by Cabinet Office Ordinance, and as referred to in Article 66-33, paragraph (2) of the Act, shall be the parties set forth in the following items, in accordance with the categories of parties as set forth respectively therein (including persons who are deemed to be substantially the same as these persons):

(i) in cases where the object of a Credit Rating is the assessment of the credit status of any juridical person:such juridical person (excluding the juridical person set forth in Article 24, paragraph (1), item (iv) of the Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act), and the consignee of the business affairs related to the structure of said juridical person; and

(ii) in cases where the object of a Credit Rating is the assessment of the credit status of financial instruments: the issuers of said financial instruments (limited to the case where said financial instruments are Securities), obligor (limited to the case where said financial instruments are loan claims) or consignees of the business affairs related to the structures of said financial instruments.

(2) Notwithstanding the provision of the preceding paragraph, the person specified by Cabinet Office Ordinance, as referred to Article 66-33, paragraph (2) of the Act, in cases where the object of a Credit Rating is the assessment of the credit status of the Asset Securitization Products, shall be as follows (including persons deemed to be substantially the same as these persons):

(i) a principal holder of the Underlying Assets as specified in Article 295, paragraph (3), item (i), sub-item (a)1. or (b)1. or 2., when said Asset Securitization Products satisfy the requirements set forth in Article 295, paragraph (3), item (i), sub-item (a) or (b);

(ii) a third party (limited to a principal third party) as set forth in Article 295, paragraph (3), item (i), sub-item (c)1. or (d)1., when said Asset Securitization Products satisfy the requirements set forth in Article 295, paragraph (3), item (i), sub-item (c) or (d);

(iii) a Special Purpose Juridical Person as set forth in Article 295, paragraph (3), item (i), sub-item (a) or (c), in cases where said Asset Securitization Products satisfy the requirements set forth in Article 295, paragraph (3), item (i), sub-item (a) or (c); and

(iv) a consignee of business affairs related to the structures of said Asset Securitization Products.

(3) The provision of paragraph (1), item (ii) shall apply to cases where the object of the Credit Rating is the assessment of the credit status of the Securities or claims pertaining to a monetary loan which satisfy any of requirements listed in Article 295, paragraph(3), item(i), sub-item (a) to (e) inclusive, and where the assessment of the credit status satisfies the requirement listed in sub-item (f) of that item, by deeming the assessment of the credit status of the Underlying Assets as specified in sub-item (f) of that item to be the object of the Credit Rating, and cases where the object of the Credit Rating is the assessment of the credit status of the Securities or claims pertaining to a monetary loan which satisfy any of requirements listed in Article295, paragraph(1), sub-item (a) to (e)

inclusive, and where the assessment of the credit status satisfies the requirement listed in sub-item (g) of that item, by deeming the assessment of the credit status of Securiteis issued by a single person who concludes a contract pertaining to a monetary loan or claims pertaining to a monetary loan to the said person to be the object of the Credit Rating.

Article 308 (Close Relationship with a Rating Stakeholder)

(1) The close relationship specified by Cabinet Office Ordinance, as referred to in Article 66-35, item (i) of the Act, shall be the relationship between the Credit Rating Agency or its Officers or employees, and the Rating Stakeholders, in cases where any of the following situations applies:

(i) where the Person in Charge of Rating of the Credit Rating Agency is the Officer of the Rating Stakeholder or has assumed any other position equivalent thereto;

(ii) where the Person in Charge of Rating of the Credit Rating Agency is the relative (limited to a spouse, and a relative by blood and a relative by affinity of the first degree of kinship) of the Officer or any other person equivalent thereto of the Rating Stakeholder (excluding the cases specified in the preceding item);

(iii) where the Credit Rating Agency or its Person in Charge of Rating is a holder of Securities (excluding Securities as set forth in Article 2, paragraph (1), item (i) and item (ii) of the Act and Securities as set forth in item (xvii) of that paragraph (limited to Securities which have the nature listed in item (i) and item (ii) of that paragraph) issued by the Rating Stakeholder; or

(iv) where the Credit Rating Agency or its Person in Charge of Rating is a person entitled to any rights related to Derivatives Transactions (limited to Derivative Transactions related to the Rating Stakeholders or Securities issued by the Rating Stakeholders)

(2) The holder as set forth in item (iii) of the preceding paragraph and the person entitled to the right set forth in item (iv) of that paragraph shall include the persons listed in the following persons, in addition to a person who, under its name or any other person's name (including a fictitious name), owns the Securities (including a person who has a right to request the delivery of Securities based on a sale and purchase or any other contract) or is entitled to such right:

(i) a person who has been vested with the authority to exercise the voting rights or any other rights as a shareholder of the issuing company of Securities or the authority to give instructions on the exercise of said voting rights or any other rights, in accordance with the provisions of a monetary trust contract or any other contracts or of the laws; and

(ii) a person who has been vested with the authority necessary to make an investment in Securities, in accordance with the provision of a Discretionary Investment Contract or any other contracts or of the laws.

Article 309 (Matters in Which Rating Stakeholders Have Interests)

The matters specified by Cabinet Office Ordinance, as referred to in Article 66-35, item (i) of the Act shall be as follows:

(i) the assessment of the credit status of the Rating Stakeholder;

(ii) the assessment of the credit status of financial instruments, in cases where the Rating Stakeholder is an issuer (limited to the case where said financial instruments are Securities) or obligor (limited to the case where said financial instruments are loan claims)of said financial instruments; and

(iii) the assessment of the credit status of financial instruments or juridical persons pertaining to certain structures, in cases where the Rating Stakeholder is the consignee of business affairs related to such structures.

Article 310 (Matters Which May Materially Influence Credit Rating)

The matters specified by Cabinet Office Ordinance, as referred to in Article 66-35, item (ii) of the Act, shall be as follows:

(i) the organizational scheme of the juridical person and the composition of the principal assets and liabilities thereof, in cases where the object of the Credit Rating is the assessment of the credit status of such juridical person or Securities issued by such juridical person; and

(ii) material matter on the structures of financial instruments or the structures of claim pertaining to a monetary loan held against a juridical person, in cases where the object of the Credit Rating is the assessment of such financial instruments or juridical person.

Article 311 (Manner of Advice Excluded from Application of Prohibition)

The case specified by Cabinet Office Ordinance, as referred to in Article 66-35, item (ii) of the Act, shall be the case where the Credit Rating Agency, in response to a request from the Rating Stakeholder, has provided an explanation as to how the information or facts provided by the Rating Stakeholder may affect the determination of Credit Rating, in accordance with the Rating Determination Policy, etc. and any matter incidental thereto.

Article 312 (Prohibited Acts)

The acts specified by Cabinet Office Ordinance, as referred to in Article 66-35, item (iii) of the Act, shall be as follows:

(i) an act to promise any Rating Stakeholder, prior to implementing the Credit Assessment (meaning a Credit Assessment as defined in Article 2, paragraph (34) of the Act; hereinafter the same shall apply in this Chapter), to provide or make available to the public certain Credit Rating as a result of said Credit Assessment (excluding an act to provide in advance any Rating Stakeholder with a Credit Rating estimated based on the Rating Determination Policy, etc. and any other information incidental thereto);

(ii) the act of any Person in Charge of Rating of a Credit Rating Agency, in the process of determining a Credit Rating, of accepting any money or goods delivered by any Rating Stakeholder, to demand the delivery thereof, or to accept an offer for the delivery thereof

(excluding the cases where the total value of such money or goods received in the same day is three thousand yen or less, and the cases as may be necessary in the course of trade); and

(iii) in cases where the object of a Credit Rating is the assessment of the credit status of Asset Securitization Products, the act of refusing to determine a Credit Rating for the assessment of credit status of such Asset Securitization Products, merely on the grounds that any other Credit Rating Agency had already determined a Credit Rating for the assessment of the credit status of such Asset Securitization Products or the relevant Underlying Assets.

Article 313 (Matters to be Contained in Rating Policy, etc.)

(1) A Rating Policy, etc. as referred to in Article 66-36, paragraph (1) of the Act shall provide for the following matters:

(i) the policy and method concerning the determination of Credit Ratings (hereinafter referred to as the "Rating Determination Policy, etc." in this Chapter); and

(ii) the policy and method concerning acts to provide or make available to the public the Credit Ratings (hereinafter referred to as the "Rating Provision Policy, etc." in this Article).

(2) The Rating Determinaion Policy, etc. shall satisfy the following requirements:

(i) that it is rigorous and systematic;

(ii) that it provides that, for the purpose of making a judgment, any and all collected information pertaining to the credit status of financial instruments and juridical persons (limited to the cases where the object of the Credit Rating is the assessment of such credit status) shall be comprehensively taken into account;

(iii) that it provides for the following matters, in accordance with the categories of objects of Credit Rating and detailed items thereof:

(a) the criteria used for identifying the matters which serve as the assumptions for the assessment of the credit status, and the criteria used for the setting of grades indicating the results of the assessments of the credit status; and

(b) an outline of the method for the determination of Credit Ratings.

(iv) that it provides for the policies and methods which enable a Rating Stakeholder, in advance of providing or making available to the public the determined Credit Rating, to verify whether there was any factual misperception as to the principal information used by the Credit Rating Agency in dettermining the Credit Rating (including policies and methods for securing a reasonable length of time which allows the Rating Stakeholder to express its opinions); and

(v) that it provides for the policies and methods for determining a Credit Rating, in cases of determining a Credit Rating without a solicitation from any Rating Stakeholder;

(3) The Rating Provision Policy, etc. shall satisfy the following requirements:

(i) that it provides that acts to provide or to make available to the public the determined Credit Ratings are to be implemented without delay after the determination of such Credit

Rating;

(ii) that it provides that the acts to provide or to make available to the publicthe determined Credit Ratings should be implemented for the general public;

(iii) that it provides that, in cases where the determined Credit Ratings are to be provided or made available to the public, the following matters shall be announced by use of the internet or by any other means; provided, however, that in cases where the object of the Credit Rating is the assessment of the credit status of Asset Securitization Products, the Credit Rating Agency may, in lieu of the matters specified in sub-item (e) (limited to the names of the persons set forth in Article 307, paragraph (2), item (i) or (ii)), announce the business type, business size and location of the parties listed in item (i) or (ii) of that paragraph as well as any reasons for not announcing said information:

(a) the trade name or name and the registration number of the Credit Rating Agency, and the details of the supervisory measures taken against the Credit Rating Agency in the most recent one year;

(b) the year, month and date of determining the Credit Rating;

(c) the name of the Lead Rating Analyst participated in the process of determining the Credit Rating, and the name of the person who, as a representative of the Credit Rating Agency, is responsible for determining Credit Ratings;

(d) an outline of the matters set forth in item (iii) of the preceding paragraph and the objects of the Credit Rating, as adopted for the purpose of determining the Credit Rating (in cases where two or more methods for determining a Credit Rating have been adopted, including such fact and the grounds therefor);

(e) the name of the Rating Stakeholder;

(f) in cases where the object of the Credit Rating is the assessment of the credit status of the Asset Securitization Products, and where the design of such products substantially deviates from the design of Asset Securitization Products that the Credit Rating Agency determined the Credit Rating in the past;

(g) in cases where the Credit Rating was determined without any solicitation from the Rating Stakeholder, such fact, and information as to whether any undisclosed information (limited to the information which is fond to have material influence on the Credit Rating)had been obtained from the Rating Stakeholder in the process of determining the Credit Rating;

(h) in cases where the Credit Rating Agency does not intend to update the determined Credit Rating, such fact and the grounds therefor;

(i) an explanation on the assumptions, significance and limitations of the determined Credit Rating, in accordance with the category of the object of such Credit Rating (including an explanation on the characteristics of the fluctuation of Credit Ratings; and also including an explanation on the limitations of the Credit Rating, in cases where the object of the Credit Rating is the assessment of the credit status of the financial instruments with limited information on the transition of the credit status);

(j) the following matters concerning the principal information used in the course of

determining the Credit Rating:

1. an outline of said information;
2. an outline of the measures implemented for the purpose of the quality assurance of said information; and
3. the provider of said information;

(k) the following matters, in cases where the object of the determined Credit Rating was in relation to the assessment of the credit status of the Asset Securitization Products:

1. information on the analysis of loss, cash flow and sensitivity; and
2. the symbols, figures or any other indication for clearly indicating that the object of the determined Credit Rating was the assessment of the credit status of Asset Securitization Products (including an explanation which allows investors to understand the significance and limitations of said Credit Rating based on such symbol);

(iv) that it provides that information on the withdrawal of the determined Credit Rating shall be provided without delay; and

(v) that it directs not to make any representation as to the appropriateness of the results of the Credit Assessment, which may lead to a misperception that such appropriateness has been guaranteed by the Commissioner of the Financial Services Agency or any other administrative organ.

Article 314 (Method of Announcement of Rating Policy, etc.)

(1) A Credit Rating Agency shall announce its Rating Policy, etc. in a manner which allows easy inspection by investors and Credit Rating users at any time, by means of the use of the internet or any other means.

(2) In cases where two or more Credit Rating Agencies (limited to the cases where said two or more Credit Rating Agencies fall under the category of Associated Juridical Persons, and where they share the same Officers and Representative Person in Japan or a person as set forth in Article 297) jointly perform Credit Rating Activities in the course of trade, said two or more Credit Rating Agencies may jointly formulate and announce the Rating Policy, etc.)

(3) In cases where a Credit Rating Agency intends to effect any material change to its Rating Policy, etc., it shall, in advance, announce the fact that the change will be effected and an outline of such change; provided, however, that if any unavoidable ground exists, such unavoidable ground, the fact of the change and an outline thereof may be announced without delay after the change.

Section 3 Accounting

Article 315 (Books and Documents on Business Operation)

(1) The books and documents to be prepared by a Credit Rating Agency pursuant to the provision of Article 66-37 of the Act shall be as follows:

(i) the records pertaining to the following information on the Credit Ratings determined:

(a) the determined Credit Rating, the year, month and date of determining said Credit Rating, and the object of said Credit Rating;

(b) the matters set forth in Article 313, paragraph (3), item (iii);

(c) the name of the Rating Analyst participated in the process of determining the Credit Rating; the name of the person, as a representative of the Credit Rating Agency, was responsible for determining the Credit Rating;

(d) in cases where the final decision as a Credit Rating Agency in determining the Credit Rating is to be adopted by a resolution of the council, the names of the council members, the materials submitted to the council, the basis of the decision-making and any other records (in cases where the final decision is adopted by means other than a resolution of the council, to that effect and the grounds therefor);

(e) in cases where any Associated Juridical Person participated in the process of determining the Credit Rating, the name and address of the Associated Juridical Person;

(f) in cases where the Credit Assessment was implemented based primarily on quantitative analysis, and where there exists a significant difference between the results of the Credit Assessment based on the quantitative analysis and the Credit Rating actually determined, the major grounds which provided the basis for such difference;

(g) the materials which served as the basis for the determination of the Credit Rating (including records on the progress of negotiations with the Rating Stakeholder);

(h) information as to whether the Credit Rating was determined in response to solicitation from any Rating Stakeholder;

(i) an outline of the measures implemented to verify the existence of any Conflict of Interests between the Credit Rating Agency including its Person in Charge of Ratings and any Rating Stakeholders, and any other measures implemented for preventing any Conflict of Interests;

(ii) the records on the following matters concerning the Rating Stakeholder which had paid any Rating Fee to the Credit Rating Agency;

(a) the name and address;

(b) the amount of the Rating Fee; and

(c) the details of the services for which the Rating Fee was paid.

(iii) the documents describing the outline of the services or products provided by the Credit Rating Agency;

(iv) the documents concerning the Credit Assessment which served as the basis for the determination of the Rating Determination Policy, etc. ;

(v) the documents describing the results of an investigation on the status of Compliance With Laws and Regulations, etc.;

(vi) the documents describing Specified Acts and Measures for Avoiding Conflicts of Interest;

(vii) the minutes of meetings of the Supervisory Committee;

(viii) the records on the progress of important negotiations between Officers or employees of the Credit Rating Agency and the Rating Stakeholder (limited to records concerning Credit Rating Activities);

(ix) the documents or electromagnetic records received from investors and any other users of Credit Ratings (limited to documents or electromagnetic records which contain any description of complaints regarding Credit Rating Activities); and

(x) the ledgers.

(2) The books and documents as set forth in the preceding paragraph shall be preserved for five years after the preparation thereof.

(3) In cases where two or more Credit Rating Agencies (limited to cases where said two or more Credit Rating Agencies fall under the category of Associated Juridical Persons, and where their Representative Persons in Japan or persons as set forth in Article 297 are the same) jointly perform Credit Rating Activities in the course of trade, said two or more Credit Rating Agencies may be jointly prepared for the books and documents.

Article 316 (Business Report)

(1) A business report to be submitted by a Credit Rating Agency pursuant to the provision of Article 66-38 of the Act shall be prepared in accordance with Appended Form No. 28.

(2) When a Credit Rating Agency prepares a business report as set forth in the preceding paragraph, it shall be subject to corporate accounting standards generally accepted as fair and appropriate.

Article 317 (Procedures for Obtaining Approval on Time Limit for Submission of Business Report)

(1) In cases where any Credit Rating Agency which is a foreign juridical person intends to obtain approval under the proviso to Article 18-4-2 of the Cabinet Order, it shall submit to the Commissioner of the Financial Services Agency a written application for approval stating the following matters:

(i) the trade name or name;

(ii) the registration date and the registration number;

(iii) the period for which the approval is sought in relation to the submission of the business report;

(iv) the last day of the business year pertaining to the business report; and

(v) the grounds for seeking the approval with regard to the submission of the Business Report.

(2) The following documents shall be attached to the written application set forth in the preceding paragraph:

(i) the articles of incorporation, or any other document in lieu thereof;

(ii) a document proving that the representative (including the Representative Person in Japan as set forth in Article 66-28, paragraph (1) of the Act and also including a person as set forth in Article 297) of the Credit Rating Agency which is a foreign juridical person,

as stated in the written application for approval, is a person who has been duly authorized to submit such written application for approval; and

(iii) a legal opinion stating that the matters related to laws and regulations or practices as set forth in the written application for approval are true and accurate, which shall be prepared by legal profession, as well as a copy of the relevant provisions of the applicable laws and regulations referred to in such legal opinion.

(3) In cases where the application for approval set forth in paragraph (1) was filed, and where it is found impossible for a Credit Rating Agency which is a foreign juridical person to submit the business report within three months after the end of the business year due to the laws and regulations or practices of its own state, the Commissioner of the Financial Services Agency shall grant approval with regard to the business report covering the business year containing the day of the filing of such application (in cases where such day falls within three months from the commencement of the business year (in cases where the approval has been granted with regard to the submission of a business report covering the immediately preceding business year, within the period approved), the business year immediately preceding such business year) through the business year immediately preceding the business year containing the day when the ground specified in item (v) of paragraph (1) for which the application was filed would be eliminated or changed.

(4) The approval set forth in the preceding paragraph shall be granted on the condition that the Credit Rating Agency which is a foreign juridical person, etc. as set forth in that paragraph shall submit to the Commissioner of the Financial Services Agency documents stating the following matters within three months from the end of each business year; provided, however, that with regard to the matters specified in item (ii), if the substance of such matters is identical to that stated in the documents already submitted within five years prior to the submission of such document, the statement of such matters may be omitted:

(i) that the grounds for the application for which approval was sought have not been eliminated or changed in the relevant business year; and

(ii) a legal opinion stating the matters specified in the preceding item, which shall be prepared by legal profession, as well as a copy of the relevant provisions of the applicable laws and regulations referred to in such legal opinion.

Article 318 (Matters to be Contained in Explanatory Document)

(1) The matters specified by Cabinet Office Ordinance, as referred to in Article 66-39 of the Act, shall be as follows:

(i) the following matters concerning the profile and organizational structure of the Credit Rating Agency:

(a) the trade name or name;

(b) the registration date and registration number;

(c) an outline of the organizational structure;

(d) the name of the first to tenth-ranked shareholders based on the descending order of the number of shares held, the number of shares held by such shareholders, and the ratio of the number of the voting rights pertaining to such shares to the Voting Rights Held by All the Shareholders, etc.; and

(e) the matters set forth in Article 66-28, paragraph (1), items (ii) to (v) inclusive of the Act;

(ii) the following matters concerning the status of the business of the Credit Rating Agency;

(a) an outline of the business conducted in the most recent business year;

(b) the following matters, as the indicators of the status of the business of the Credit Rating Agency for the most recent business year:

1. the sales volume (including the proportion of the consideration for services of Credit Rating Activities and the consideration for services other than Credit Rating Activities);

2. in cases where the Credit Rating Agency receives a Rating Fee exceeding ten percent of the sales volume of the Credit Rating Business from a single Rating Stakeholder (including the parties set forth in the items of paragraph (1), Article 15-16 and items of paragraph (2), Article 15-16 of the Cabinet Order), the name of said Rating Stakeholder;

3. statistical information or any other information on the transition of the credit status of the financial instruments or juridical persons (limited to cases where the object of the Credit Rating is the assessment of such credit status);

4. information on the historical data of the determined Credit Rating (limited to information at the time when one year or more has passed from the day when the Credit Rating was determined);

5. the status of Ancillary Businesses and Other Lines of Business; and

6. the total number of Rating Analysts.

(c) the schedule of fees generally applicable between the Credit Rating Agency and the Rating Stakeholder;

(iii) the status of organizing the operations control system of the Credit Rating Agency (including an outline of the following matters):

(a) the measures to be implemented so that a Person in Charge of Rating, as a party independent of a Rating Stakeholder, fairly and faithfully carries out the business, even in cases where such Person in Charge of Rating participates consecutively in the processes of determining Credit Ratings of the matter in which the same Rating Stakeholder has an interest;

(b) the measures to be implemented for establishing systems for securing the proper operation of the Rating Agency Services (meaning the measures as set forth in Article 306, paragraph (1), item (iv));

(c) the measures for securing Compliance With Laws and Regulations, etc.;

(d) the following measures concerning policies on the quality management of the Credit

Rating determining process and the implementation thereof:

1. the policy for the recruitment and training of Rating Analysts;
2. the allocation of the Rating Analysts;
3. the measures to be implemented so that the information used for determining a Credit Rating is of sufficient quality;
4. the measures to put in place the functions to properly verify the appropriateness and effectiveness of the Rating Determination Policy, etc.;
5. the measures to be implemented in cases of any material amendment to the Rating Determination Policy, etc., if any, so as to announce, without delay, the scope of the Credit Ratings already determined in accordance with the former Rating Determination Policy, etc. but which require further consideration as to the necessity for being updated in accordance with the amended Rating Determination Policy, etc. and the period of time required for such updating, as well as to update the Credit Ratings within such period of time;
6. the measures to verify the ability of the Credit Rating Agency in Determining a Credit Rating in an appropriate manner, whose object is the assessment of the credit status of Asset Securitization Products (limited to the cases where the design of said Asset Securitization Products substantially deviates from the design of the Asset Securitization Products to which it determined Credit Ratings in the past);7. the measures so that the Credit Rating Agency will be able to implement the verification and updating of a Credit Rating already determined, in an appropriate manner and on an ongoing basis;
7. the measures so that the Credit Rating Agency will be able to implement the verification and updating of a Credit Rating already determined, in an appropriate manner and on an ongoing basis;

(e) the types of Specified Acts and an outline of Measures for Avoiding Conflict of Interest;

(f) the measures to be implemented so as to verify the appropriateness of a Credit Rating of any Matter in Which Rating Stakeholder Has an Interest, in cases where any Rating Analyst who no longer assumes the position of Officer or employee of the Credit Rating Agency assumes the position of an Officer or any other position equivalent thereto of the Rating Stakeholder;

(g) the measures to be implemented so that activities pertaining to Ancillary Businesses and Other Lines of Business would not unreasonably affect the Credit Rating Activities;

(h) the measures 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;

(i) the measures to be implemented to ensure that the policy for the determination of the Remuneration, etc. of the Officers or employees of the Credit Rating Agency would not adversely affect the performance of Credit Rating Business in a fair and adequate manner;

(j) the measures to be implemented so as to prevent the Person in Charge of Rating from participating in the negotiation process for the determination of the Rating Fee for the Credit Rating;
(k) the measures to be implemented so as to properly manage information which may come to the attention of the Credit Rating Agency in the course of its Credit Rating Business, as well as to properly maintain the confidentiality thereof;
(l) the measures to be implemented so as to appropriately and swiftly address complaints raised against the Credit Rating Agency;
(m) the operational policies of the Supervisory Committee, and names of the members and the method of the appointment of the members (including a basic stance on the independence of the Independent Members); and
(n) a document describing the code of conduct to be complied with by the Credit Rating Agency as well as its Officers and employees;
(iv) an outline of the Rating Policy, etc.;
(v) the following matters concerning the status of the Associated Juridical Persons and Subsidiary Juridical Persons of the Credit Rating Agency:
(a) the composition of the group of the Credit Rating Agency and its Associated Juridical Persons and Subsidiary Juridical Persons; and
(b) the trade name or name, and locations of the principal business office or principal office of Associated Juridical Persons and Subsidiary Juridical Persons, as well as the details of their respective principal businesses.

Article 319 (Method of Public Inspection of Explanatory Documents)
(1) A Credit Rating Agency shall keep copies of explanatory documents at all of its business offices or offices and make them available for public inspection, and, in addition to this, shall announce them by such means as use of the internet so as to allow easy inspection by investors and Credit Ratings users at any time.
(2) In cases where two or more Credit Rating Agencies (limited to cases where said two or more Credit Rating Agencies fall under the category of Associated Juridical Persons, and where their Representative Persons in Japan or persons as set forth in Article 297 are the same) jointly perform Credit Rating Activities in the course of trade, said two or more Credit Rating Agencies may jointly prepare and announce the explanatory documents.

Article 320 (Procedures for Obtaining Approval on Period of Public Inspection of Explanatory Documents)
(1) In cases where any Credit Rating Agency which is a foreign juridical person intends to obtain approval under the proviso to Article 18-4-3 of the Cabinet Order, it shall submit to the Commissioner of the Financial Services Agency a written application for approval stating the following matters:
(i) the trade name or name;
(ii) the registration date and the registration number;

(iii) the period for which the approval is sought in relation to the public inspection of the explanatory documents;

(iv) the last day of the business year pertaining to the explanatory documents; and

(v) the grounds for seeking the approval with regard to the public inspection of the explanatory documents.

(2) The following documents shall be attached to the written application set forth in the preceding paragraph:

(i) the articles of incorporation, or any other document in lieu thereof;

(ii) a document proving that the representative (including the Representative Person in Japan as set forth in Article 66-28, paragraph (1) of the Act and also including a person as set forth in Article 297) of the Credit Rating Agency which is a foreign juridical person, as stated in the written application for approval, is a person who has been duly authorized to submit such written application for approval; and

(iii) a legal opinion stating that the matters related to laws and regulations or practices as set forth in the written application for approval are true and accurate, which shall be prepared by legal profession, as well as a copy of the relevant provisions of the applicable laws and regulations referred to in such legal opinion.

(3) In cases where the application for approval set forth in paragraph (1) has been filed, and where, due to the laws and regulations or practices of its own state, it is found to be impossible for a Credit Rating Agency which is a foreign juridical person to keep and make available for public inspection the explanatory documents and to announce them by such means as use of the internet from the day when four months have elapsed after the end of each business year, the Commissioner of the Financial Services Agency shall grant approval with regard to the explanatory documents covering the business year containing the day of the filing of such application (in cases where such day falls within four months from the commencement of the business year (in cases where the approval has been granted with regard to the submission of a business report covering the immediately preceding business year, within the period approved), the business year immediately preceding such business year) through the business year immediately preceding the business year containing the day when the reason specified in item (v) of paragraph (1) for which the application was filed would be eliminated or changed.

(4) The approval set forth in the preceding paragraph shall be granted on the condition that the Credit Rating Agency which is a foreign juridical person, etc. as set forth in that paragraph shall submit to the Commissioner of the Financial Services Agency the documents stating the following matters within four months from the end of each business year; provided, however, that with regard to the matters specified in item (ii), if the substance of such matters is identical to that stated in the documents already submitted within five years prior to the submission of such document, the statement of such matters may be omitted:

(i) that the grounds for application for which approval was sought have not been eliminated or changed in the relevant business year; and

(ii) a legal opinion stating the matters specified in the preceding item, which shall be prepared by legal profession, as well as a copy of the relevant provisions of the applicable laws and regulations referred to in such legal opinion.

Section 4 Supervision

Article 321 (Notification of Discontinuance of Business, etc.)

(1) A person who intends to file a notification pursuant to the provision of Article 66-40, paragraph (1) of the Act shall submit to the Commissioner of the Financial Services Agency a written notification stating the matters listed in the following items, in accordance with the categories of the cases set forth respectively therein:

(i) the case falling under Article 66-40, paragraph (1), item (i) of the Act (excluding the cases where the following item and item (iii) applies): the date of and reason for the discontinuance;

(ii) the case falling under Article 66-40, paragraph (1), item (i) of the Act (limited to cases where the Credit Rating Agency has had all of its business pertaining to Credit Rating Business succeeded to through a split): the following matters:

(a) the trade name or name of the successor; and

(b) the date of and grounds for the split;

(iii) the case falling under Article 66-40, paragraph (1), item (i) of the Act (limited to cases where the entire Credit Rating Business was transferred): the following matters:

(a) the trade name or name of the transferee; and

(b) the date of the transfer and the grounds therefor;

(vi) the case falling under Article 66-40, paragraph (1), item (ii) of the Act: the following matters:

(a) the trade name or name of the counterparty to the merger;

(b) the date of and grounds for the merger; and

(c) the method of implementing the merger;

(v) the case falling under Article 66, paragraph (1), item (iii) of the Act: the following matters:

(a) the day when the petition for the commencement of bankruptcy proceedings was filed; and

(b) the day when the order for the commencement of bankruptcy proceedings was issued.

(vi) the case falling under Article 66-40, paragraph (1), item (iv) of the Act: the date of and grounds for the dissolution.

(2) The documents listed in the following items shall be attached to the written notification set forth in the preceding paragraph, in accordance with the categories of the cases set forth respectively therein:

(i) the case falling under Article 66-40, paragraph (1), item (ii) of Act: the document stating the contents of the merger agreement and the procedures for the merger; and

(ii) the cases falling under item Article 66-40, paragraph (1), item (iii) of Act: a copy of

the written judgment on the order for the commencement of bankruptcy proceedings, or a document stating the details of the order for the commencement of bankruptcy proceedings.

Article 322 (Public Notice, etc. on Discontinuance, etc. of Business)

(1) The public notice under Article 66-40, paragraph (3) of the Act shall be given by means of publication in the official gazette or in a daily newspaper that publishes matters on current affairs.

(2) The following matters shall be stated in a written notification as set forth in Article 66-40, paragraph (4) of the Act:

(i) the trade name or name;

(ii) the registration date and the registration number;

(iii) the grounds on which the notification was filed; and

(iv) the day when the grounds for filing the notification are scheduled to occur.

Article 323 (Public Notice for Persons Whose Whereabouts are Unidentifiable)

The public notice prescribed in Articles 66-42, paragraph (3) of the Act shall be given by means of publication in the official gazette.

Article 324 (Public Notice of Supervisory Disposition)

The public notice prescribed in Articles 66-43 of the Act shall be given by means of publication in the official gazette.

Article 325 (Matters to be Taken into Account for Purpose of Application)

In cases where the Commissioner of the Financial Services Agency exercises the authority under Article 66-41, Article 66-42, paragraphs (1) or (2) or Article 66-45, paragraph (1) of the Act, he/she shall pay attention not to be involved in the individual Credit Ratings or the specific details of the method of Credit Assessment.

Article 328 (Standard Processing Period)

(1) In cases where any application for registration, authorization, approval, permission or confirmation listed in any of the following items has been filed, the Commissioner of the Financial Services Agency or other official shall endeavor to render the disposition related to such application within the period set forth respectively in the relevant items, counting from the date of the arrival of such application at the relevant office:

(i) a registration under Article 29, Article 33-2, Article 66 and Article 66-27 of the Act, an authorization under Article 30, paragraph (1) of the Act and a permission under Article 60, paragraph (1) of this Act: two months;

(ii) (omitted)

(2) (omitted)

Appended Form No. 27 (Re: Article 296 and Article 304)

(JIS A4)
(Page No. 1)

Year: _____ Month: _____ Date: _____

To: Commissioner of the Financial Services Agency

Applicant (Postal Code)

Address or Location

Telephone Number ( ) -

Trade Name or Name

Name and Title of Representative (Seal)

Application for Registration

Pursuant to the provision of Article 66-28 of the Financial Instruments and Exchange Act, the applicant hereby submits an application for registration under Article 66-27 of the same Act.

The applicant hereby certifies that the matters contained in this written application and the documents attached hereto are true.

(Note)

1. The applicant shall affix the same seal as indicated in the notification of seal impression already submitted by such applicant; provided, however, that the signature may be affixed for any inevitable reason.
2. The applicant shall attach a certificate of seal impression pertaining to the seal impression affixed (excluding the case where the signature is affixed).

*	Registration Number	Commissioner of the Financial Services Agency (Credit Rating Agency) No. _____ (YY/MM/DD)
1	Whether the applicant has a juridical personality	
2	(in Japanese syllabary) Trade Name or Name	
3	Name of officers (in case of a foreign juridical person, officers shall include its representative in Japan; and in case of an organization without a juridical personality for which a representative person or administrator has been designated, officers shall include such representative person or administrator)	As per specified in Appendix No. 1
4	Name and location of the business office or office to carry out Credit Rating Business (in case of a foreign juridical person: its head office, principal business office or other principal office in Japan, or any other business office or office in Japan)	As per specified in Appendix No. 2
5	Type of other lines of business	As per specified in Appendix No. 3
6	Name of the registration applicant's representative person in Japan as set forth in Article 66-28, paragraph (1) of the Act or the person set forth in Article 297 (limited to the case where the registration applicant is a foreign juridical person)	
7	Trade name or name, and location of the head office, principal business office or other principal office of another registration applicant or another Credit Rating Agency that falls under the category of an Associated Juridical Person of the registration applicant and performs the Credit Rating Activities jointly with the registration applicant	As per specified in Appendix No. 4
8	Trade name or name, and location of head office, principal business office or other principal office of the registration applicant's Associated Juridical Persons	As per specified in Appendix No. 5

	(excluding another registration applicant or another Credit Rating Agency that falls under the category of an Associated Juridical Person of the registration applicant and performs Credit Rating Activities jointly with the registration applicant)	
9	The name of the state where the head office, principal business office or other principal office of the registration applicant (limited to a foreign juridical person) is located; and, in cases where the registration applicant is subject to supervision by any Administrative Organ, etc. in that state, said fact, and the name and location of said Administrative Organ, etc.	As per specified in Appendix No. 6
10	Name of Chief Compliance Officer	
11	Name of person in charge of supervising Rating Analysts in the process of determining a Credit Rating	
12	Names of members of Supervisory Committee	

(Note)

1. Please do not enter any information in the column "＊registration number."
2. With regard to the column, "Whether the applicant has a juridical personality," in cases where the registration applicant has a juridical personality, please also indicate the provisions pursuant to which such juridical personality has been granted.
3. With regard to the column, "Names of members of Supervisory Committee," in cases where a member is an Independent Member, please note such fact in parentheses.

(Appendix 1: Names of Officers (in case of a foreign juridical person, officers shall include its representative in Japan; and in case of an organization without a juridical personality for which a representative person or administrator has been designated, officers shall include such representative person or administrator))

Trade Name or Name

(As of YY/MM/DD)

(in Japanese syllabary) Name	Title

(Appendix 2: Name and location of the business office or office to carry out Credit Rating Business (in case of a foreign juridical person: its head office, principal business office or other principal office in Japan, or any other business office or office in Japan))

Trade Name or Name

(As of YY/MM/DD)

Name	Location

(Appendix 3: Type of other lines of business)

Trade Name or Name

(As of YY/MM/DD)

Type of other lines of business

(Appendix 4: Trade name or name, and location of the head office, principal business office or other principal office of another registration applicant or another Credit Rating Agency that falls under the category of an Associated Juridical Person of the registration applicant and performs Credit Rating Activities jointly with the registration applicant)

Trade Name or Name

(As of YY/MM/DD)

Trade Name or Name	Location of head office, principal business office or other principal office	
	Name	Location

(Appendix 5: Trade name or name, and location of the head office, principal business office or other principal office of the registration applicant's Associated Juridical Persons (excluding another registration applicant or another Credit Rating Agency that falls under the category of an Associated Juridical Person of the registration applicant and performs Credit Rating Activities jointly with the registration applicant)

Trade Name or Name

(As of YY/MM/DD)

Trade Name or Name	Location of head office, principal business office or other principal office	
	Name	Location

(Appendix 6: Name of the state where the head office, principal business office or other principal office of the registration applicant (limited to a foreign juridical person) is located; and, in cases where the registration applicant is subject to supervision by any Administrative Organ, etc. in that state, said fact, and the name and location of said Administrative Organ, etc.)

Trade Name of Name

(As of YY/MM/DD)

State Name	Supervision	Administrative Organ, etc.	
		Name	Location

(Note)

1. In the column, "State Name," please indicate the name of the state where the head office, principal business office or other principal office of the registration applicant is located.
2. In cases where the registration applicant is subject to supervision by any Administrative Organ, etc. in the relevant state, please state "yes" in the column, "Supervision," as well as the name and location of such Administrative Organ, etc. in the column, "Administrative Organ, etc."

Appended Form No. 28 (Re: Article 316, paragraph (1))

(JIS A4)

Business Report
for __th business year (From: YY/MM/DD
To: YY/MM/DD)

Date of Submission: YY/MM/DD

Trade Name or Name
Location
Title and Name of Representative (Seal)

1 Status of Business

(1) Date of registration and registration number

YY/MM/DD (Commissioner of the Financial Services Agency (Credit Rating Agency) No. _____)

(2) Type of Business

(3) Outline of business conducted in the business year

(4) Status of officers and employees

(i) Total number of officers and employees

	Officers	Part-time officers	Employees	Total
Total Number	(_____)	(_____)	(_____)	(_____)
Number of Rating Analysts				

(ii) Status of officers

Title	Name	Positions at other companies concurrently held		
		Trade Name	Title	Whether the officer has been granted authority of representation

(iii) Status of Chief Compliance Officer

Name

(iv) Status of a person in charge of supervising Rating Analysts in the process of determining a Credit Rating

Name

(v) Status of members of Supervisory Committee

Name

(vi) Status of Rating Analysts

Name of Section	Number of Rating Analysts Belonging to the Section

(5) Status of business offices

Name	Location	Number of Officers and Employees

Total number of business offices: _____		____ in total

(6) Status of shareholders

Name	Address or Location	Ratio
Others (Number of shareholders ____)		%
Total number of shareholders:		100.00%

(Note)

1. Status of business

(1) Type of business

Please describe the details of the Credit Rating Activities performed in the course of trade and the categories of the objects of the Credit Ratings pertaining to said activities, and other lines of business conducted by the registration applicant, as of the end of the business year. If any change has occurred in the business year, please note such change.

(2) Outline of business conducted in the business year

Please provide a brief outline of business activities and business performance for the business year, and a summary of any other important matters that had an impact on the business performance in the business year. (In case of a foreign juridical person, please also provide a brief outline of business activities and business performance in Japan, and a summary of any other important matters that had an impact on business performance in Japan.)

(3) Status of officers and employees

(i) Total number of officers and employees

Please state the number of officers and employees incumbent as of the end of the business year. In case of a foreign juridical person, please state, in parentheses immediately below such information, the number of officers and employees assigned to its business office or office in Japan.

(ii) Status of officers

Please describe information on officers incumbent as of the end of the business year. In the column, "Positions at other companies concurrently held," please state the trade name or name of the other company at which the person concurrently assumes the position of officer, the title of the position assumed at such other company, and whether such person has been

granted the authority of representation; provided, however, that for an accounting advisor, company auditor, or an officer of a foreign juridical person who is not an officer assigned to its business office or office in Japan, no entry in the column, "Positions concurrently held by officers," is required.

(iii) Status of members of Supervisory Committee

In cases where a member of the Supervisory Committee is an Independent Member, please note such fact in parentheses.

(iv) Status of Rating Analysts

Please describe information on Rating Analysts incumbent as of the end of the business year. In the column, "Section Name," please note, in parentheses, the categories of the objects of Credit Rating that such section will handle. In case of a foreign juridical person, in the column, "Number of Rating Analysts Belonging to the Section," please state, in parentheses, the number of Rating Analysts assigned to its business office or office in Japan.

(4) Status of business offices

Please describe information on all business offices or offices including the Head Office, etc. as of the end of the business year. In cases where, during the business year, any business office or other office has been established or abolished, or where there has been any change to the name or address of the business office or other office, please note such fact.

(5) Status of shareholders

Please describe information on the first to tenth-ranked shareholders (meaning the first to tenth-ranked shareholders as set forth in Article 318, item (i), sub-item (d)) and any other shareholder as of the end of the business year. In the column "Ratio," please indicate the ratio as set forth in sub-item (d) of such item to the second decimal place, truncating all digits after the third decimal place.

(7) Status of business

Please describe information on the status of the Credit Rating Business, Ancillary Business and Other Line of Business conducted in the business year. If there is any fraction less than one unit, such fraction shall be truncated.

(i) Total number of Credit Ratings determined as of the end of the business year, and the breakdown per category of the objects of Credit Ratings:

Category	Number of Credit Ratings determined as of the end of the business year

Total	

(Note)

1. The categories of the objects of the Credit Ratings shall be in conformity with the categories as set forth in the Rating Policy, etc.
2. In case of a foreign juridical person, please state, in parentheses, the number of Credit Ratings determined in Japan.

(ii) The names of the first to twentieth-ranked customers of the Credit Rating Agency, based on descending order of the amount of Rating Fee (meaning the Rating Fee as defined in Article 306, paragraph (1), item (x), sub-item (b)) paid to the Credit Rating Agency in the business year, and the amount of the Rating Fee:

Name	Amount

(Note)

In case of a foreign juridical person, please also describe the names and amounts of Rating Fee pertaining to the first to twentieth-ranked customers in Japan.

(iii) Aggregate amount of the Remuneration, etc. of Rating Analysts

(iv) Statistical or any other information on the transition of a credit status of financial instruments or juridical persons (limited to the case where the assessment of such credit status is the object of the Credit Rating)

(Note)

In cases where two or more Credit Rating Agencies jointly carry out the Credit Rating Activities in the course of trade (limited to the case where the two or more Credit Rating Agencies fall under the category of Associated Juridical Persons and where they share the same Representative Person in Japan or a person set forth in Article 297), and where it is difficult to separately identify information pertaining to each Credit Rating Agency, statistical or any other information prepared jointly by said two or more Credit Rating Agencies may be stated, provided that a reasonable explanation is added.

(v) Status of Ancillary Business and Other Line of Business

Details of Business

(Note)

In case of a foreign juridical person, please also describe the status of its Ancillary Business in Japan and Other Line of Business in Japan.

2. Accounting Status

A Credit Rating Agency may prepare and submit a balance sheet, and a profit and loss statement.

3. Status of Associated Juridical Persons

Name	Location of principal business office or other principal office	Contents of principal business	Account of relationship

(Note)

1. Please describe information on the Associated Juridical Persons as of the end of the business year. In cases where any change has occurred during the business year, please note such change.
2. In the column, "Account of relationship," please state whether the Associated Juridical Person is a Subsidiary Juridical Person of the Credit Rating Agency, another juridical person that holds the Credit Rating Agency as its Subsidiary Juridical Person, or a Subsidiary Juridical Person of another juridical person that holds such Credit Rating Agency as its Subsidiary Juridical Person (excluding such Credit Rating Agency), as well as whether the relationship is a share-capital relationship or a personnel relationship.

Annex 4d

Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc. (Supplement)
Guidelines for Supervision of Credit Rating Agencies

I. Basic Concept

I-1 Basic Concept of Supervision of Credit Rating Agencies

Credit ratings are used extensively in financial and capital markets as a reference for investors to evaluate credit risk when making investment decisions. They significantly influence the investment decisions of investors. At this time of financial crisis, various problems have been pointed out with regard to the credit rating agencies that determine and publish these kinds of credit ratings, including the possibility of conflicts of interest, the validity of rating processes, and the sufficiency of information disclosure.

The purpose of supervising credit rating agencies is, in view of these kinds of problems, to ensure the appropriate business operations of credit rating agencies, and to bring about the appropriate exercise of their functions.

To this end, an important role of supervisory departments is to require credit rating agencies to ensure thorough legal compliance, including the development of operational control systems for conducting their credit rating business fairly and appropriately. Ways of achieving this include properly grasping the state of business operations of credit rating agencies through periodic and continuous hearings and other means, and accumulating and analyzing various data and information provided by the credit rating agencies, encouraging them to make voluntary improvement efforts in order to ensure the appropriateness of their business.

On the other hand, concerning the regulation of credit rating agencies under the Financial Instruments and Exchange Act (hereinafter referred to as “FIEA”), given that a credit rating is an opinion expressed about an indefinite credit risk in the future based on expert knowledge, the approach that has been taken is that it would be inappropriate to make the actual substance of individual credit ratings subject to regulation. Further, in Article 325 of the Cabinet Office Ordinance on Financial Instruments Business, etc. (hereinafter referred to as the “FIB Cabinet Office Ordinance”) as well, it has been made clear that the Commissioner of the Financial Services Agency, when exercising his/her statutory authority over credit rating agencies, should be careful not to get involved in any individual credit ratings or in the specific details of how credit is assessed. Supervisory departments shall act while giving due consideration to this point.

In addition, for details on the basic concepts pertaining to the supervision of credit rating agencies, reference shall be made to “I-1 Basic Concept for Supervision of Financial Instruments Business Operators, etc.” in the *Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.* (hereinafter referred to as “*Comprehensive Guidelines*”).

I-2 Purpose of Establishing the Supervisory Guidelines

In order to enable the Japanese economy to achieve sustainable development, it is important to accelerate the shift of funds “from savings to investment,” which means a shift in emphasis from indirect financing to direct financing and market-based indirect financing. In order to promote the shift of funds from savings to investment, in addition to designing appropriate institutional frameworks, because credit rating agencies provide credit ratings that serve as reference information for investors when they make investment decisions, it is essential that financial authorities properly motivate credit rating agencies to enhance internal control systems that are attentive to, *inter alia*, the protection of investors.

For this reason, for the purpose of conducting routine supervision of credit rating agencies, it was decided to prepare an approach to supervisions, points of focus and attention when conducting supervision, and specific supervisory techniques.

These Guidelines were compiled with due consideration of the actual state of credit rating agencies so that they could be applied to various cases, and as such, not all supervisory evaluation points contained in these Guidelines should be uniformly applied to all credit rating agencies.

Accordingly, when applying these Guidelines, it is necessary to bear in mind that, even if a credit rating agency does not meet the requirements of individual evaluation points word for word, the case shall not be judged inappropriate insofar as there is no problem from the viewpoint of protecting public interests and investors. That is, care needs to be taken to avoid applying the Guidelines in a mechanical and uniform fashion. On the other hand, it should also be remembered that, even if a credit rating agency formally possesses all the functions relating to the evaluation points, in some instances, the case could be deemed to be inappropriate from the viewpoint of protecting public interests and investors.

II. Notes on the Administrative Processes for the Supervision of Credit Rating Agencies

Notes on the administrative processes for the supervision of credit rating agencies shall be treated in accordance with “II. Points of Attention in the Conduct of Administrative Processes Regarding the Supervision of Financial Instruments Business Operators, etc.” in the *Comprehensive Guidelines*.

III. Supervisory Evaluation Points and Various Administrative Procedures

III-1 Governance

In order for credit rating agencies to fulfill their function in the financial and capital markets appropriately, it is important that they endeavor to improve their own systems for legal compliance and that they enhance their internal control systems which are attentive to, *inter alia*, the protection of investors. For this reason, in conducting routine supervisory affairs, it is necessary to examine what type of governance at a credit rating agency is considered preferable, from such viewpoints as whether the management team's supervision of the credit rating agency's business execution is functioning effectively, and whether the monitoring and control of the management team is functioning effectively.

In conducting this kind of examination of governance, supervisory departments shall, in accordance with "III-1 Governance (General)" and "IV-1-1 Officers of Financial Instruments Business Operators" in the *Comprehensive Guidelines*, examine whether each function of the representative director, individual directors and the board of directors, individual auditors and the board of auditors, and the internal audit division are being appropriately fulfilled in keeping with the characteristics, size, complexity and other attributes of the credit rating agency's business.

III-2 Appropriateness of Business

III-2-1 Development of Operational control systems

Article 66-33(1) of the FIEA requires credit rating agencies to develop an operational control system for the purpose of conducting their credit rating business fairly and appropriately. With regard to the items in the operational control system which are required to be provided under the provisions of Article 306(1) of the FIB Cabinet Office Ordinance, credit rating agencies need to develop a system of a certain depth and level that is appropriate to the characteristics, size, complexity and other attributes of its own business.

Under Article 306(5) of the FIB Cabinet Office Ordinance, credit rating agencies that conduct business as a group are, under certain conditions, permitted to jointly develop an operational control system as a group; however, even in this case, they need to develop an appropriate system in view of the characteristics, size, complexity and other attributes of the business conducted by each individual credit rating agency.

When a credit rating agency develops its operational control system, the board of directors and so forth need to properly fulfill their functions so that a company-wide operational control system can be established. Furthermore, based on Article 306(5) of the FIB Cabinet Office Ordinance, in cases where credit rating agencies that conduct business as a group jointly develop an operational control system as a group, they need to ensure that there is appropriate cooperation between the board of directors and so forth of each credit rating agency.

(Note) In such cases, it should be kept in mind that no part of the operational control system can be assigned to an unregistered business operator even if it is a credit rating agency within a group. For example, in cases where the rating determination policy, etc. (the policies and methods relating to the determination of credit ratings; the same shall apply hereinafter), which were formulated by an unregistered business operator within the group, are used “as is” by a credit rating agency, and where that credit rating agency does not have the authority to make revisions themselves, then it should be kept in mind that it may not be found that the said credit rating agency has taken sufficient measures for putting in place functions to properly examine the validity and effectiveness of rating determination policy, etc. (see III-2-1(5)(iv)).

Furthermore, in addition to internal rules, etc. being properly developed, in order for an operational control system that is based on the spirit of the law to be established, there needs to be conditions and systems in place whereby, more than just formulating, revising and issuing notifications about the system, there is reliable dissemination and promulgation to officers and employees by way of training and other means. Moreover, in order to ensure the effectiveness of the operational control system, in addition to the internal checks and balances function of internal audits and so forth being adequately demonstrated, there also needs to be conditions and systems in place whereby the internal rules, etc. can be revised

as needed based on examinations of the validity and effectiveness of the operational control system.

Based on this, supervisory departments shall examine how credit rating agencies have developed their operational control systems, by taking the following points, for instance, into consideration, for each item prescribed in Article 306(1) of the FIB Cabinet Office Ordinance.

(1) Measures pertaining to instances where a person in charge of rating is consecutively involved in processes relating to the determination of a credit rating on a matter in which the same rating stakeholder has an interest (rotation rule)

(i) Whether the credit rating agency has clearly established in advance whether it will use both or select one of either of the measures prescribed in Article 306(1)(ii)(A) or (B) of the FIB Cabinet Office Ordinance (and the application criteria of each measure in cases where it uses both).

(ii) Whether the credit rating agency has properly recorded and stored credit ratings in which a lead rating analyst or a member of the credit rating committee (refers to the consultative body which makes the final decision for the credit rating agency regarding the determination of credit ratings; the same shall apply hereinafter) has been involved in the rating process, so that it can properly adhere to the measures prescribed in Article 306(1)(ii)(A) or (B) of the FIB Cabinet Office Ordinance.

(2) Measures to prevent the employment of persons regarding whom there is significant doubt as to whether credit rating activities would be conducted fairly

Whether the credit rating agency has properly established a policy for the employment of officers and employees so that it can employ persons who have the necessary abilities and experience and required professional ethics to conduct credit rating activities fairly, and whether it is making appointments appropriately in accordance with that policy. Also, whether the credit rating agency examines the validity and effectiveness of the said policy in a timely and appropriate manner, and makes revisions as necessary.

(3) Measures for ensuring the appropriateness of the business of a credit rating agency (internal control system)

(i) Whether the board of directors, etc. recognizes the importance of developing internal control systems for the purpose of ensuring the appropriateness of the company business activities, and whether it has built an adequate system suited to the characteristics, size, complexity and other attributes of its own business.

(ii) Whether the credit rating agency periodically examines the validity and effectiveness of the internal control system it has built, and makes revisions as necessary.

(4) Measures for ensuring legal compliance

(i) Notes regarding the policy and procedures pertaining to legal compliance

(a) Whether the credit rating agency regards legal compliance as one of the most important issues for management, and whether it has formulated a basic policy concerning the implementation of compliance, as well as a detailed implementation plan (compliance program) and a code of conduct (ethics code, compliance manual, etc.).

(b) Whether the credit rating agency has clearly established the authority and responsibility of the chief compliance officer, and whether there is a system in place for his/her function to be fully exercised.

(c) Whether the credit rating agency has established a system for communicating and reporting compliance-related information appropriately among the management team, the divisions in charge of the credit rating activities, and the legal compliance division, chief compliance officer or other person in charge.

(d) Whether the credit rating agency has established and enhanced systems for training and education on legal compliance, and whether it strives to foster and raise awareness of legal compliance among officers and employees. Also, whether it strives to ensure the effectiveness of training by, for example, conducting evaluation and follow-up in a timely manner and by reviewing and revising the contents thereof.

(Note) In addition, supervisory departments shall also take III-2-2 into consideration regarding legal compliance pertaining to the prohibited acts of credit rating agencies and of their officers and employees.

(ii) Notes regarding the whistle-blowing system

(a) Whether the credit rating agency has clearly designated the division in charge of the whistle-blowing system and established specific procedures for handling internal allegations, so as to ensure that they are processed and a response is made in a prompt and appropriate manner.

(b) Whether the credit rating agency has developed a system wherein information on the content of internal allegations can be shared within a necessary and appropriate scope.

(c) Whether the credit rating agency makes sure to properly follow up on how internal allegations are being handled.

(d) Whether the credit rating agency accurately and appropriately records and stores the details of internal allegations and the results of investigations thereof, and whether it makes full use of this information such as to improve its operational control system and to formulate measures for preventing a recurrence.

(iii) Development of operational control systems for identify credit ratings that are subject to the FIEA

From the perspective of developing operational control systems for ensuring legal compliance, it is important that a credit rating agency, which is a foreign corporation,

conducts its business activities after first clarifying which of its credit rating activities are subject to the FIEA. As such, supervisory departments shall examine these credit rating agencies by taking the following points into consideration.

(a) Whether the credit rating agency, taking into account the nature of its own business, has established in advance specific procedures for identifying the scope of credit ratings that are subject to the FIEA. Also, whether the credit rating agency, in accordance with these procedures, appropriately specifies and clarifies which of the credit ratings it determines are subject to the FIEA.

(b) Whether the credit rating agency periodically examines the validity of the specified scope of credit ratings that are subject to the FIEA, and makes revisions as necessary.

(c) Whether the credit rating agency has clearly stated in its rating policy, etc. (the policies and methods for determining and providing credit ratings, or for making them available for inspection; the same shall apply hereinafter) which of the credit ratings it determines are subject to the FIEA.

(Note) Basic concept of the laws and regulations pertaining to credit ratings determined by foreign corporations

Given that credit ratings are used extensively in financial and capital markets as a reference for investors to evaluate credit risk when making investment decisions, the FIEA regulations on credit rating agencies are designed for the full utilization of the functions of Japan's capital market and for the protection of investors. In view of this, credit ratings determined by a credit rating agency that is a foreign corporation, which are determined at an overseas location, and which could be brought into Japan, are beyond the scope of FIEA regulation.

This means, for example, that FIEA regulation does not apply to those credit rating activities related to a credit rating determined at an overseas location by a credit rating agency that is a foreign corporation and which satisfies each of the following conditions (hereinafter referred to as a "non-Japan-related rating"):

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

ii) The rating stakeholders are not domiciled within Japan; and

iii) In the case of asset securitization products, the main underlying assets are not located in Japan.

On the other hand, even a credit rating determined by a credit rating agency that is a foreign corporation, if it is determined at a location in Japan, will not fall under the category of a non-Japan-related rating, and so FIEA regulation will apply.

(5) Measures pertaining to the formulation and implementation of policies for controlling quality in processes relating to the determination of credit ratings

(i) Measures for securing sufficient personnel who have expert knowledge and skills and who can conduct credit rating business appropriately and smoothly

(a) Policy related to the appointment and training of credit rating analysts

Whether the credit rating agency has properly established a policy for the appointment and training of credit rating analysts so that it can secure sufficient persons who have expert knowledge and skills and who can conduct credit rating business appropriately and smoothly, and whether it is making appointments and conducting training appropriately in accordance with that policy. Also, whether the credit rating agency examines the validity and effectiveness of the said policy in a timely and appropriate manner, and makes revisions as necessary.

(b) Assignment of credit rating analysts

Whether the credit rating agency has appropriately assigned the necessary number of credit rating analysts to conduct credit rating business appropriately and smoothly.

(c) Credit rating committee

Whether the credit rating agency has clearly established the authority and responsibility of the credit rating committee, and whether it has properly established the process for appointing committee members, the process by which the credit rating committee will make decisions and other procedures pertaining to the administration of the committee. Also, whether the credit rating committee is functioning effectively, such as whether it is appropriately exercising its invested authority.

(d) Person who is responsible for supervising credit rating analysts in the process pertaining to the determination of credit ratings

Whether the credit rating agency has clearly established the authority and responsibility of the person who is responsible for supervising credit rating analysts in the process pertaining to the determination of credit ratings, and whether it has properly established the process for appointing such a person. Also, whether the person who is responsible for supervising credit rating analysts is functioning effectively, such as whether he/she is appropriately exercising his/her invested authority.

(ii) Measures for ensuring sufficient quality for the information used in determining credit ratings

Whether the credit rating agency has properly established a policy and procedures for ensuring the quality of information provided by rating stakeholders for the purpose of determining a credit rating, and whether it examines the information appropriately in accordance with that policy and procedures. Also, whether the credit rating agency examines the validity and effectiveness of the policy and procedures in a timely and appropriate manner, and makes revisions as necessary.

(iii) Measures to prevent a credit rating from being determined in cases where the credit rating agency cannot secure sufficient personnel having expert knowledge and skills for determining the credit rating, or in cases where it cannot ensure sufficient quality for the information used in determining the credit rating

Whether, in determining a credit rating, the credit rating agency appropriately examines if personnel having expert knowledge and skills have been sufficiently secured, and if the quality of the information used in determining the credit rating has been sufficiently ensured, and whether there is a system in place to prevent credit ratings from being determined when either of these cannot be adequately guaranteed. Also, whether the credit rating agency examines the validity and effectiveness of the said system in a timely and appropriate manner, and makes revisions as necessary.

(iv) Measures for putting in place functions to properly examine the validity and effectiveness of rating determination policy, etc. (including the validity and effectiveness of rating determination policy, etc. for asset securitization products in cases where there has been a change in the characteristics of the credit status of the assets underlying the said asset securitization products)

(a) Whether the credit rating agency has properly established a policy and procedures for examining the validity and effectiveness of rating determination policy, etc., and whether it appropriately examines them in accordance with that policy and procedures. Also, whether the credit rating agency examines the validity and effectiveness of the policy and procedures in a timely and appropriate manner, and makes revisions as necessary.

(b) Whether the credit rating agency has clearly established in advance the criteria for what cases correspond to “cases where there has been a change in the characteristics of the credit status of the assets underlying the asset securitization products,” and whether it appropriately examines the validity and effectiveness of rating determination policy, etc. for asset securitization products. Also, whether, in view of market trends and the characteristics of the asset securitization products, the credit rating agency examines the validity of the said criteria in a timely and appropriate manner, and makes revisions as necessary.

(v) Measures pertaining to the update of credit ratings that have been determined based on rating determination policy, etc., in cases where there have been important changes in the said rating determination policy, etc..

(a) Whether the credit rating agency has clearly established in advance the criteria for what cases correspond to “important changes,” and whether it appropriately determines the necessity for updating credit ratings. Also, whether, in view of market trends and the characteristics of the asset securitization products, the credit rating agency examines the validity of the said criteria in a timely and appropriate manner, and makes revisions as necessary.

(b) Whether the credit rating agency has properly established a policy and procedures pertaining to the update of credit ratings, and whether it conducts updates appropriately in accordance with that policy and procedures. Also, whether the credit rating agency examines the validity and effectiveness of the policy and procedures in a timely and appropriate manner, and makes revisions as necessary.

(vi) Measures for verifying that the credit rating agency can appropriately determine credit ratings for asset securitization products that are substantially different in design to asset securitization products for which it has determined credit ratings in the past

(a) Whether the credit rating agency has clearly established in advance the criteria for which cases correspond to “cases where there are substantial differences in design to asset securitization products for which it has determined credit ratings in the past,” and whether it appropriately determines the necessity for conducting the verification. Also, whether the credit rating agency examines the validity of the said criteria in a timely and appropriate manner, and makes revisions as necessary.

(b) Whether the credit rating agency has properly established a policy and procedures for cases where it determines a credit rating for an asset securitization product that is substantially different in design to asset securitization products for which it has determined credit ratings in the past, and whether it conducts examinations appropriately in accordance with that policy and procedures. Also, whether the credit rating agency examines the validity and effectiveness of the policy and procedures in a timely and appropriate manner, and makes revisions as necessary.

(vii) Examination and update of determined credit ratings

Whether the credit rating agency has properly established a policy and procedures pertaining to the examination and update of determined credit ratings, and whether it appropriately and continuously conducts examinations and updates in accordance with the policy and procedures. Also, whether the credit rating agency examines the validity and effectiveness of the policy and procedures in a timely and appropriate manner, and makes revisions as necessary.

(6) Measures for preventing conflicts of interest related to the credit rating business

(i) Development of systems for identifying conflicts of interest or acts with potential conflicts of interest

(a) Whether the credit rating agency has, through appropriate means, specified and categorized in advance conflicts of interest or acts with potential conflicts of interest (hereinafter referred to as “specified acts”).

(b) In identifying specified acts, whether the credit rating agency has appropriately reflected the characteristics, size, complexity and other attributes of its business.

(c) Whether the credit rating agency examines the validity and effectiveness of the specified acts, which it has specified and categorized, in a timely and appropriate

manner, and makes revisions as necessary.

(ii) Measures for avoiding conflicts of interest

(a) Whether the credit rating agency has properly established measures for avoiding conflicts of interest consistent with the characteristics of the specified acts it has specified and categorized.

(b) Whether the credit rating agency has developed a system wherein it can confirm, when necessary, whether there is a conflict of interest or a potential conflict of interest when conducting its credit rating activities. Whether the credit rating agency takes appropriate measures for avoiding conflicts of interest in cases where there is a conflict of interest or a potential conflict of interest.

(c) Whether the credit rating agency examines the validity and effectiveness of its measures for avoiding conflicts of interest in a timely and appropriate manner, and makes revisions as necessary.

(d) Whether the credit rating agency has clearly established in advance the criteria for which cases correspond to cases where “a person in charge of rating conducts a sale, purchase or other transaction of securities, etc. with a potential conflict of interest” as prescribed in Article 306(1)(vii)(A)1. of the FIB Cabinet Office Ordinance, and “cases where there is a potential conflict of interest between an officer or employee and a rating stakeholder” as prescribed in clause (A)2. of the same article; and in applicable cases, whether there is a system in place to prevent officers and employees from being involved in processes relating to the determination of the credit rating. Also, whether the credit rating agency examines the validity and effectiveness of the said criteria in a timely and appropriate manner, and makes revisions as necessary.

(iii) Measures for publicizing, through appropriate means, the types of specified acts and an outline of its measures for avoiding conflicts of interest

Whether the credit rating agency appropriately publicizes the types of specified acts and an outline of its measures for avoiding conflicts of interest, through methods such as posting such information on its website.

(7) Measures to prevent acts pertaining to ancillary business and other business operations from having an undue influence on credit rating activities

(i) Whether the credit rating agency, having first clarified its own ancillary business and other business operations, has specified and categorized in advance, through appropriate means, any acts pertaining to these business operations which have the potential to have an undue influence on its credit rating activities.

(ii) Whether the credit rating agency has, consistent with the characteristics of the acts it has specified and categorized, taken appropriate measures to prevent such acts from having an undue influence on its credit rating activities, for instance, by conducting management based on the separation of divisions. Also, whether the credit rating

agency examines the validity and effectiveness of the said measures in a timely and appropriate manner, and makes revisions as necessary.

(8) Measures whereby a third party can examine the validity of credit ratings pertaining to asset securitization products from an independent standpoint

(i) In publicizing “items of information which are deemed important for a third party to assess the validity of the said credit rating” as prescribed in Article 306(1)(ix)(A) of the FIB Cabinet Office Ordinance, whether the credit rating agency has made it possible for a third party to gain an appropriate understanding of the content and risks of asset securitization products. Also, whether the credit rating agency examines the validity of the said items of information in a timely and appropriate manner, and makes revisions as necessary.

(ii) Whether the credit rating agency has clearly established a policy and procedures with respect to approaches to rating stakeholders, encouraging them to take “measures whereby a third party can examine the validity of the said credit rating” (Article 306(1)(ix)(B) of the FIB Cabinet Office Ordinance), and with respect to the disclosure of the content and results of those approaches (clause (C) of the same article). Also, in addition to appropriately storing records pertaining to the content and results of those approaches, whether the credit rating agency examines the validity and effectiveness of the policy and procedures based on the said records, in a timely and appropriate manner, and makes revisions to the policy and procedures as necessary.

(9) Measures pertaining to the policy for determining the remuneration, etc. of officers and employees

Whether the credit rating agency has properly established a policy for determining the remuneration, etc. of officers and employees, and whether it is applying the policy appropriately. Also, whether the credit rating agency examines, in a timely and appropriate manner, whether the content of the said policy is undermining the fair and appropriate execution of its credit rating business, and whether it makes revisions as necessary.

(10) Measures for preventing person in charge of ratings from participating in negotiations for credit rating fees

Whether the credit rating agency clearly prohibits its person in charge of ratings from participating in negotiations for credit rating fees. Also, whether the credit rating agency has taken appropriate measures, such as separating the division that conducts its credit rating activities from the division that negotiates the credit rating fees.

(11) Measures for the appropriate conduct of information management and confidentiality

(i) Whether the credit rating agency has established specific criteria for the treatment of

information and secrets acquired during the course of its credit rating business, and whether it has fully communicated these criteria to all officers and employees. In particular, whether the credit rating agency has, as part of these criteria, clearly prohibited the information and secrets from being used for purposes other than those purposes deemed necessary to conduct the credit rating business fairly and appropriately.

(ii) In addition to identifying the scope of confidentiality and those persons who acquire confidential information in the course of their duties, whether the credit rating agency has, for the purpose of managing confidentiality, put systems in place designed to prevent the leaking of confidential information—for example, by managing access to confidential information, by formulating measures to prevent the removal of confidential information by insiders, and by making the information management system more robust so as to prevent unauthorized access from the outside. Also, whether there is a system in place whereby the credit rating agency can examine, in a timely and appropriate manner, how the said information and secrets are being managed.

(12) Measures for dealing with complaints appropriately and quickly

(i) Whether the credit rating agency has clearly designated the division that is in charge of complaints and inquiries from rating stakeholders, investors and other credit-rating users, and whether it has established specific procedures for handling them, so as to ensure that the complaints and so forth are processed and a response is made in a prompt and appropriate manner. Whether the credit rating agency has developed a system wherein information about complaints and inquiries that could have a material impact on the management of the agency can be properly shared, such as including them in the matters to be reported to the management team.

(ii) Whether the credit rating agency has developed a system for providing full explanations in the event it receives a complaint or inquiry. Whether it makes sure to properly follow up on how complaints and inquiries are being handled.

(iii) Whether the credit rating agency, by appropriately accumulating and analyzing information on complaints and inquiries, makes full use of this information such as to improve its operational control system and to formulate measures for preventing a recurrence.

(13) Measures for conducting the credit rating business in accordance with rating policy, etc.

(i) More than just simply formulating, revising and issuing notifications about the rating policy, etc., whether there is a system in place to reliably disseminate and promulgate them to officers and employees by way of training and other means.

(ii) In order to ensure the effectiveness of compliance with rating policy, etc., whether there is a system in place for the internal checks and balances function of internal audits and

so forth to be adequately demonstrated.

(iii) Based on examinations of the effectiveness of compliance with rating policy, etc., whether responses are being taken as needed, such as revision of the rating policy, etc..

(14) Measures for preventing false representations and other such indications being made about the general nature pertaining to the results of credit status assessments of financial instruments and corporations

Whether the credit rating agency has developed necessary systems, such as explicitly prohibiting false representations from being made about the general nature pertaining to the results of the credit status assessment of a financial instrument or corporation, or other indications from being made which may cause misunderstanding about important matters. In this case, whether the credit rating agency has promoted full communication to, and understanding among, its officers and employees, such as by presenting specific cases which could be in contravention of the prohibition.

(15) Measures to prevent the misidentification of ancillary business

Whether the credit rating agency, in cases where it also carries out acts pertaining to ancillary business, has developed a system whereby it clearly establishes that the said acts are not acts pertaining to the credit rating business.

(16) Measures pertaining to the establishment of a supervisory committee

(i) Whether the credit rating agency has ensured the independence of the supervisory committee in accordance with the purpose of system.

(ii) Whether the credit rating agency has clearly established the authority and responsibility of the supervisory committee, and whether it has properly established a process for appointing committee members, a policy for administering the supervisory committee, and a process for independent members to periodically submit their opinions.

(iii) Whether the supervisory committee exercises its invested authority properly, and conducts effective supervisory activities.

(iv) Whether the supervisory committee reports to the management team, without delay, any important issues identified in the process of its supervisory activities.

(v) Whether the credit rating agency makes appropriate improvements with respect to matters pointed out by the supervisory committee. Also, whether the supervisory committee appropriately examines the progress of improvements made with regard to those matters raised.

III-2-2 Prohibited Acts

(1) Prohibition, etc. of the provision/inspection of a credit rating in cases where there is a close

relationship with a rating stakeholder

In cases where there is a “close relationship” with a rating stakeholder, Article 66-35(i) of the FIEA prohibits credit rating agencies and their officers and employees from engaging in acts of providing or making available for inspection a credit rating on a matter in which the said rating stakeholder has an interest.

In relation to this, as part of their development of operational control systems to prevent conflicts of interest related to the credit rating business, Article 306(1)(vii)(A) of the FIB Cabinet Office Ordinance requires credit rating agencies to implement measures, etc. designed to prevent their persons in charge of rating from conducting sales, purchases or other transaction of securities, etc. with a potential conflict of interest (see III-2-1(6)).

Supervisory departments shall examine these points by taking the following points into consideration.

(i) In determining credit ratings, whether the credit rating agency has developed, in advance, systems whereby it can confirm, when necessary, the relationships between the credit rating agency and its officers and employees on the one hand and a rating stakeholder on the other (including whether there is any sale, purchase or other transaction of securities, etc. relating to the rating stakeholder).

(ii) Whether there is a system in place to prevent officers and employees from being involved in processes relating to the determination of a credit rating, not only in cases where the relationship between the credit rating agency and its officers and employees and a rating stakeholder correspond to a “close relationship,” but also in cases where “a person in charge of rating conducts a sale, purchase or other transaction of securities, etc. with a potential conflict of interest” as prescribed in Article 306(1)(vii)(A)1. of the FIB Cabinet Office Ordinance, and “cases where there is a potential conflict of interest between an officer or employee and a rating stakeholder” as prescribed in clause (A)2. of the same article.

(2) Prohibition of the concurrent provision of consulting activities

From the perspective of ensuring the fairness of the rating process, ensuring the independence of credit rating agencies and avoiding conflicts of interest, Article 66-35(ii) of the FIEA prohibits credit rating agencies and their officers and employees from engaging in acts of providing or making available for inspection a credit rating in cases where they have provided advice to a rating stakeholder on a matter that could be expected to have a material influence on the said credit rating related to the said rating stakeholder.

At the same time, in order to prevent appropriate business communication between credit rating agencies and rating stakeholders from being impeded, pursuant to the provisions of Article 311 of the FIB Cabinet Office Ordinance, credit rating agencies are permitted, at the request of a rating stakeholder, to provide an explanation on the effects

that information or facts provided by the rating stakeholder would have on the determination of the credit rating, based on the agency's rating determination policy, etc. and on matters related to this.

In view of these points, it is important for credit rating agencies to establish operational control systems whereby they can appropriately keep track of the progress of negotiations with rating stakeholders. As such, supervisory departments shall conduct examinations by taking the following points, for instance, into consideration.

(i) Scope of advice pertaining to matters having a material influence on a credit rating

Whether the credit rating agency has clarified in its internal rules, etc. the scope of advice that is prohibited. In this case, whether the credit rating agency has promoted full communication to, and understanding among, its officers and employees, such as by presenting specific cases of advice which could be in contravention of the prohibition.

(ii) Keeping track of the progress of negotiations with rating stakeholders

(a) With regard to records related to the progress of negotiations with rating stakeholders, in addition to properly establishing in its internal rules, etc. the items to be listed, whether the credit rating agency has fully communicated these to its officers and employees.

(b) Whether the legal compliance division or the internal audit division strives to keep track of the progress of negotiations with rating stakeholders, and whether it examines if negotiations are being conducted appropriately; and whether it strives to establish systems for ensuring the effectiveness thereof, such as by revising the internal rules, etc. when necessary.

(3) Notes regarding the prohibition of name lending

With regard to credit rating agencies that conduct business as a group, in particular, in cases where a credit rating determined by an unregistered business operator within the group is made to appear as though it was determined by a credit rating agency which is registered, and where the rating is provided or made available for inspection, it should be kept in mind that such instances could fall under the category of name lending, which is prohibited under Article 66-34 of the FIEA.

On the other hand, for a credit rating in which an unregistered business operator within the group is involved in its determination, in cases where:

- the credit rating agency examines whether the business activity pertaining to the said credit rating has been conducted appropriately under an adequate operational control system and in accordance with the rating policy, etc. of the said credit rating agency; and
- after having verified that there are no problems, the credit rating agency approves the determination of the said credit rating, or the credit rating committee passes a resolution (if the credit rating is found to have problems, then the approval of or

resolution on the said credit rating is not conducted),
it should be kept in mind that the said credit rating, which has either been approved by the credit rating agency or resolved by the credit rating committee, will be recognized as having been determined by the credit rating agency, and will not fall under the category of name lending to an unregistered business operator within the group.

III-2-3 Information Disclosure

(1) Notes regarding the formulation and disclosure of rating policy, etc.

Supervisory departments shall examine the appropriateness of the formulation and disclosure of rating policy, etc. by taking the following points into consideration.

(i) In making information public, whether the credit rating agency, having first categorized between rating determination policy, etc., and rating provision policy, etc. (policies and methods relating to the acts of providing credit ratings or making them available for inspection; the same shall apply hereinafter), makes descriptions that are appropriate and easy to understand for investors and other credit-rating users.

(ii) When making rating policy, etc. public by posting them on its internet website, whether the credit rating agency displays them in an area on the screen which is easily recognized.

(iii) Under Article 314(2) of the FIB Cabinet Office Ordinance, credit rating agencies that conduct business as a group are, under certain conditions, permitted to jointly establish and make public their rating policy, etc.. In such cases, whether the credit rating agency displays, in an easy to understand manner, the names of the credit rating agencies which have jointly formulated and publicized the rating policy, etc..

(iv) Whether the credit rating agency formulates its rating determination policy, etc. by categorizing them for each class and subclass of items that are subject to credit ratings, in accordance with the characteristics, size, complexity and other attributes of the said credit rating agency.

(v) With respect to the rating determination policy, etc., when clearly stating the “policies and processes for enabling a rating stakeholder to check in advance whether there are any factual errors with respect to the main information used by a credit rating agency in determining a credit rating, prior to the credit rating agency conducting acts of providing the said credit rating or making it available for inspection (including policies and processes for ensuring a reasonable amount of time needed for the said rating stakeholder to express his/her opinions)” (Article 313(2)(iv) of the FIB Cabinet Office Ordinance), whether the credit rating agency has clearly and appropriately stated, not only the policies and processes for ensuring a reasonable amount of time needed for the said rating stakeholder to express his/her opinions, but also the handling of instances where time is needed to check whether there are any factual errors.

(vi) With respect to the rating provision policy, etc., regarding the “symbols, numbers or other notation for clearly stating that the items subject to an determined credit rating are an evaluation pertaining to the credit status of an asset securitization product” (Article 313(3)(iii)(k)(2) of the FIB Cabinet Office Ordinance), whether the credit rating agency uses symbols or numbers that are different to the symbols or numbers pertaining to the credit status of corporations or of financial instruments other than asset securitization products. However, in cases where it is found that using different symbols or numbers would not be appropriate from such perspectives as ensuring international consistency for rating codes, it should be kept in mind that it is also possible to clearly state that the symbols or numbers are an evaluation pertaining to the credit status of an asset securitization product by using footnotes or other such methods.

(2) Notes regarding explanatory documents

A credit rating agency shall not be precluded from including in its explanatory documents, at its own discretion, items that are in addition to those items prescribed by laws and regulations. Where necessary, supervisory departments shall check the date on which an individual credit rating agency furnished its branches with the explanatory documents. In addition, supervisory departments shall conduct examinations by taking the following points into consideration.

(i) Whether the explanatory documents are ready to be inspected at anytime at the request of a customer. Also, whether the credit rating agency appropriately publicizes its explanatory documents through methods such as posting them on its website.

(ii) In cases of a credit rating agency that is a foreign corporation, whether it has described as “measures for ensuring legal compliance” (Article 318(iii)(C) of the FIB Cabinet Office Ordinance):

- specific procedures for identifying the scope of credit ratings that are subject to the FIEA (see III-2-1(4)(iii)); and
- with respect to the prohibition of name lending, the details of measures it has taken so that each credit rating can be recognized as having been determined by the credit rating agency (see III-2-2(3)).

(iii) Under Article 319(2) of the FIB Cabinet Office Ordinance, credit rating agencies that conduct business as a group are, under certain conditions, permitted to jointly draw up and make public their explanatory documents. In such cases, whether the items listed in the explanatory documents have been described for each credit rating agency, except for those items for which such a description would be difficult (for example, the development of operational control systems, an outline of the rating policy, etc., etc.).

III-2-4 Supervisory Method and Actions

As part of its routine supervisory activities, when a supervisory department, based on the

above viewpoints, recognizes an issue concerning a credit rating agency as a result of conducting periodic and continuous hearings, etc. with officers and employees of the credit rating agency (with regard to a credit rating agency that is a foreign corporation, basically with representative persons in Japan or with officers and employees stationed at business sites or offices in Japan), it shall identify and keep track of the status of voluntary improvements made by the credit rating agency, by requiring, when necessary, the submission of reports based on the provisions contained in Article 66-45(1) of the FIEA. Moreover, in cases where the credit rating agency is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisory department shall take action, such as issuing a business improvement order based on the provisions of Article 66-41 of the FIEA.

Furthermore, in cases where a credit rating agency is a foreign corporation, supervisory departments shall cooperate appropriately with the authorities in the home country of the said credit rating agency.

III-3 Various Administrative Procedures

III-3-1 Registration

(1) Using a seal on the application for registration

A signature specified in the instructions for filling out the form may be used in lieu of a seal if the representative person is not accustomed to using a seal.

(2) Representative persons in Japan and business sites and offices in Japan

(i) It should be kept in mind that, with credit rating agencies that are a foreign corporation, the representative person in Japan and the officers and employees stationed at business sites or offices in Japan need to have an appropriate understanding of the business situation of the said credit rating agency, and need to be capable of properly explaining this situation to investors, other credit-rating users and to the authorities.

(ii) It should be kept in mind that, with credit rating agencies that are a foreign corporation, there needs to be a system in place at their business sites and offices in Japan, whereby the officers, employees, etc. stationed at the said business sites and offices can check with materials (internal rules, etc.) by which they can ascertain the status of the development of operational control systems of the said credit rating agency. Furthermore, with regard to books and documents, even in cases where they are stored at an overseas location of the said foreign corporation, it should be kept in mind that there needs to be a system in place whereby the officers, employees, etc. stationed at business sites or offices in Japan can check with the said books and documents within a reasonable period of time.

(3) Documents to be attached to the application for registration

(i) An extract of the certificate of residence shall be submitted, containing the following items:

(a) Address

(b) Full name

(c) Date of birth

(d) Registered domicile

(ii) A copy of the certificate of residence in one’s home country submitted by a foreign national living outside Japan, or any other document equivalent thereto (a Japanese translation shall be attached to all documents written in English, etc.) shall fall under the “documents in lieu thereof” prescribed in Article 300(1)(ii)(B) of the FIB Cabinet Office Ordinance.

(4) Examined items

When examining whether a corporation is deemed to have the necessary systems in place for conducting the credit rating business fairly and appropriately, as prescribed in Article 66-30(1)(v) of the FIEA, supervisory departments shall, in view of Article 303 of the FIB Cabinet Office Ordinance, check the following points based on the application for registration, the attached documents and hearings:

(i) Whether the operational control system of the registration applicant is appropriate and suited to the characteristics, size, complexity and other attributes of the business it conducts.

(ii) As a result of examining the matters below in a comprehensive manner, whether it can be recognized that there is the danger of the credibility of the credit rating business being forfeited due to an officer or employee having qualities inappropriate for managing business in terms of relationships or other circumstances with organized crime groups (the organized crime groups prescribed in Article 2(ii) of the Act on Prevention of Unjust Acts by Organized Crime Group Members; the same shall apply hereinafter) or with organized crime group members (the organized crime group members prescribed in Article 2(vi) of the same act; the same shall apply hereinafter).

(a) Whether the officer or employee is a member of an organized crime group (including cases where he/she was a member of an organized crime group in the past).

(b) Whether the officer or employee has a close relationship with an organized crime group.

(c) Whether the officer or employee has been fined (including similar punishments imposed under foreign laws or regulations equivalent thereto) for violating the provisions of the FIEA, another finance-related law or regulation in Japan or an equivalent law or regulation in a foreign country.

(d) Whether the officer or employee has been fined (including similar punishments imposed under foreign laws or regulations equivalent thereto) for violating the provisions of the Act on Prevention of Unjust Acts by Organized Crime Group Members (excluding the provisions in Article 32-2(7)) or the provisions of a foreign law or regulation equivalent thereto, or for committing a crime under the Penal Code or the Act on Punishment of Physical Violence and Others.

(e) Whether the officer or employee has been sentenced to imprisonment or a more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto). (Particular attention should be paid to the case of an officer or employee being accused of committing crimes specified under Articles 246 to 250 of the Penal Code (fraud, computer fraud, breach of trust, quasi fraud, and extortion as well as an attempt at these crimes).

(5) Handling of registration numbers

(i) Registration numbers entered into the Registry of Credit Rating Agencies shall be as

follows.

For example: Commissioner of the Financial Services Agency (Rating) No.___

The numbers 4, 9, 13, 42, 83, 103 and 893 shall be skipped.

(ii) When a registration is no longer valid, the applicable registration number shall be retired and shall not be replaced.

(iii) Registration numbers shall be managed using the Register of Credit Rating Agency Registration Numbers on the Attached Form III-1.

(6) Notification to registration applicants

When a credit rating agency is registered in the Registry of Credit Rating Agencies, a notification of registration shall be issued to the registration applicant using Attached Form III-2.

(7) Refusal of registration

(i) When a registration is refused, a notification of refusal of registration shall be isssued to the registration applicant using Attached Form III-3. The notification shall include the grounds for refusal, and shall state that the applicant is entitled to make a formal objection to the Commissioner of the Financial Services Agency and to file an action against the government for the decision to be reversed.

(ii) The notification of refusal of registration shall explicitly and specifically state the paragraph numbers of each of the paragraphs in Article 66-30 of the FIEA which corresponds to the grounds for refusal (and the corresponding item numbers in cases where the grounds correspond to individual items in Article 66-30(1)), or the areas in the application for registration and the attached documents where there are false statements regarding important matters or where there are statements on important matters missing.

(8) Registry of Credit Rating Agencies

(i) The Registry of Credit Rating Agencies shall be prepared based on the sections from pages 2 through 12 of the copy of the application for registration.

(ii) When a notification of change is submitted for matters stated on an application for registration, the relevant page of the Registry of Credit Rating Agencies shall be replaced with the revised page of the application for registration attached to the said notification.

(iii) The days for inspecting the Registry of Credit Rating Agencies shall be on days other than the holidays for administrative organs prescribed in Article 1 of the Act on Holidays of Administrative Organs, and the time for inspection shall be within the hours designated by the Commissioner of the Financial Services Agency. However, the inspection date or the inspection time may be changed when it is necessary to

adjust or otherwise arrange the Registry of Credit Rating Agencies.

(iv) A person inspecting the Registry of Credit Rating Agencies shall be required to enter the prescribed matters into the Schedule for Inspecting the Registry of Credit Rating Agencies using Attached Form III-4.

(v) The Registry of Credit Rating Agencies shall not be removed from the inspection area designated by the Commissioner of the Financial Services Agency.

(vi) In cases where a person inspecting the registry falls under any of the following categories, their viewing may be suspended or refused:

(a) Any person who does not abide by items (iii) through (v) above or who does not follow the instructions of the authorities

(b) Any person who has defaced or damaged, or is likely to deface or damage, the Registry of Credit Rating Agencies

(c) Any person who has inconvenienced, or is likely to inconvenience, other persons inspecting the registry, etc.

III-3-2 Notification

With regard to notifications of discontinuance of business by a credit rating agency, when receiving a notification from a credit rating agency based on Article 66-40(1) and (4) of the FIEA, supervisory departments shall make sure that no reason exists for the rescission of registration pursuant to Article 66-42(1) of the FIEA, such as by conducting hearings with the said credit rating agency as necessary.

III-3-3 Approval for Exclusion from the Application of Operational control systems

Under Article 306(6) of the FIB Cabinet Office Ordinance, a credit rating agency that is a foreign corporation may, with the approval of the Commissioner of the Financial Services Agency, be excluded from application of each of the following obligations relating to the development of operational control systems, apart from those obligations relating to business sites or offices in Japan, in cases where it is recognized that the credit rating agency can conduct business fairly and appropriately by implementing alternative measures, and if it is recognized that it is being appropriately supervised by the authorities in its home country with respect to the fair and appropriate conduct of business as a result of implementing the said alternative measures. Regarding the approval, supervisory departments shall take into consideration the points stated in each of the following items, in accordance with the classification of each item.

Following the approval, in such cases as where a problem is found in the execution of the alternative measures, supervisory departments shall consider necessary actions, including the rescission of approval based on Article 306(8) of the FIB Cabinet Office Ordinance.

(1) Exclusion from the application of “measures pertaining to instances where a person in

charge of rating is consecutively involved in processes relating to the determination of a credit rating on a matter in which the same rating stakeholder has an interest (rotation rule)”

From the perspective of ensuring the quality of the rating process and keeping collusive relationships with rating stakeholders in check, whether the credit rating committee functions effectively, and whether the rating process has been properly built, such as by ensuring restraint through the internal audit division. Also, whether the credit rating agency has taken appropriate measures for preventing entrenchment in the process for the appointment of person in charge of ratings.

(2) Exclusion from the application of “measures for ensuring the appropriateness of the business of a credit rating agency (internal control system)”

Whether the credit rating agency has built solid internal control systems for ensuring the appropriateness of business, in accordance with the laws and regulations of the home country of the said foreign corporation.

(3) Exclusion from the application of “measures for preventing conflicts of interest related to the credit rating business”

(i) Exclusion from the application of “measures for ensuring that the interests of investors are not harmed in the determination of a credit rating on a matter in which a rating stakeholder has an interest, in certain cases where there is a potential conflict of interest between the credit rating agency and the said rating stakeholder”

Whether the credit rating agency has taken appropriate measures for preventing conflicts of interest related to the credit rating business of the said foreign corporation, in accordance with the laws and regulations of the home country of the said foreign corporation.

(ii) Exclusion from the application of “measures for preventing person in charge of ratings from approaching a rating stakeholder for the purpose of being employed as an officer of that rating stakeholder”

Whether the credit rating agency has taken appropriate measures for preventing credit rating activities from being unduly influenced, in such cases as where a person in charge of rating attempts to gain employment as an officer of a rating stakeholder.

(iii) Exclusion from the application of “measures for examining the validity of a credit rating on a matter in which a rating stakeholder has an interest, and in which a credit rating analyst was involved in processes relating to its determination in the two years prior to the date of his/her resignation, in cases where the said credit rating analyst who is no longer an officer or employee of the credit rating agency has gained employment as an officer of the said rating stakeholder”

Whether the credit rating agency has properly established a policy and procedures for

examining the results of past work of a credit rating analyst in cases where the said credit rating analyst has taken up alternative employment as an officer of a rating stakeholder.

(4) Exclusion from the application of “measures for enabling a third party to examine from an independent standpoint the validity of a credit rating related to asset securitization products”

Whether the credit rating agency has implemented measures whereby an independent third party can examine the validity of a credit rating related to asset securitization products, in accordance with the laws and regulations of the home country of the said foreign corporation.

(5) Exclusion from the application of “measures pertaining to the establishment of a supervisory committee”

Whether the credit rating agency has built solid governance for ensuring appropriateness of business by having a consultative body, which includes outside directors and other external persons, examine the appropriateness of the operational control system.

III-3-4 Books and Documents

The following points shall be considered for books and documents.

(1) Basic points to consider

(i) Whether the credit rating agency has stipulated in its internal rules, etc. specific methods for preparing and storing the books and documents listed in Article 315 of the FIB Cabinet Office Ordinance.

(ii) In cases where a book or document doubles as another book or document, or where part of a book or document is made into a separate book, whether this is kept to within a reasonable scope so as not to interfere with examining the appropriateness of business, and whether all the items to be listed are entered in accordance with the type of each book and document.

(2) Storage of books and documents using electronic media

Whether the following points have been ensured in cases where books and documents are stored using electronic media.

(i) Handwritten books and documents shall be saved as image data.

(ii) The electronic media used for storage shall have sufficient durability to last for the storage period prescribed in Article 315(2) of the FIB Cabinet Office Ordinance.

(iii) One of the electronic media used for data storage shall be designated as “original,”

and shall be clearly labeled to that effect. (The state of preservation of a book or document shall be determined based on this “original.”)

(iv) A backup of the “original” in (iii) above shall be created and stored as a “copy.”

(v) The system shall allow for prompt responses to client inquiries.

(vi) The system shall allow for a ledger of hard copies to be created within a reasonable period of time based on the stored data.

(vii) The system shall allow for records of deletions and corrections to be tracked if entered data is deleted or corrected.

(viii) The system shall be able to accommodate internal audits.

(ix) Persons responsible for creation and storage shall be assigned, and internal rules on the said creation and storage shall be developed.

(x) When a handwritten postscript or supplement is made to a hard copy of a book or document created electronically, the said hard copy shall be saved as image data. If it is not saved as image data, the said hard copy shall be stored as the original.

(Attached Form III-1) (Japanese Industrial Standards A4)

Register of Credit Rating Agency Registration Numbers

Financial Service Agency

Registration number	Date of registration	Name of credit rating agency
(Rating) No.___	(YYYY/MM/DD)	

(Note) If registration has been rescinded, draw a line through the entry.

(Attached Form III-2) (Japanese Industrial Standards A4)

Document number:
Date:

(Trade name)
To: (Full name of representative person)

Commissioner of the Financial Services Agency (seal)

Registration of credit rating business

In accordance with Article 57(3) of the Financial Instruments and Exchange Act as applied mutatis mutandis pursuant to Article 66-48 of the same act, I hereby notify that registration regarding the application filed on (YYYY/MM/DD) has been completed as follows:

Date of registration: (YYYY/MM/DD)
Registration number: Commissioner of the Financial Services Agency (Rating) No.___

(Attached Form III-3) (Japanese Industrial Standards A4)

Document number:
Date:

(Trade name)
To: (Full name of representative person)

Commissioner of the Financial Services Agency (seal)

Refusal of registration of credit rating business

In accordance with Article 57(3) of the Financial Instruments and Exchange Act as applied mutatis mutandis pursuant to Article 66-48 of the same act, I hereby notify that the application for registration of credit rating business filed on (YYYY/MM/DD) has been refused on the following grounds.

If you are dissatisfied with the refusal, you may file a formal objection with the Commissioner of the Financial Services Agency based on the Administrative Appeal Act (Law No. 160, 1962) within 60 days after the date on which you become aware of the refusal.

If you request the rescission of this action in a legal proceeding, you may file an action against the national government for rescission under the Administrative Appeal Act (Law No. 139, 1962) within six months after the date on which you become aware of the refusal.

Grounds for refusal

(Attached Form III-4) (Japanese Industrial Standards A4)

Schedule for Inspecting the Registry of Credit Rating Agencies

Inspection date	Full name of person inspecting registry	Address of person inspecting registry Telephone number	Registration number	Name of credit rating agency	Time out	Time in	Seal