

**Comprehensive Guidelines for Supervision of Financial Instruments  
Business Operators, etc. (Supplement)**

**Guidelines for Supervision of Credit Rating Agencies**

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**Securities Business Division, Supervisory Bureau,  
Financial Services Agency**

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Business Operators, etc. (Supplement)  
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## **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 not 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 a 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 issued 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.