



Credit Rating System in Japan

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I. Designated Rating Agencies System in Japan

1. Overview (1)

(1) The Commissioner of the FSA designates certain CRAs as Designated Rating Agencies (“DRAs”) in accordance with the Cabinet Ordinance Concerning the Disclosure of Corporate Affairs under the Securities and Exchange Law.

The following matters are to be considered for designation:

- Rating records
- Personal structure
- Organization
- Rating methods
- Capital structure
- Neutrality from issuers
- Others



I. Designated Rating Agencies System in Japan

1. Overview (2)

**(2) A designation is to be made by setting an effective term.
The current practice is to set an effective term of two years.**

**(3) A designation is currently made public in the FSA Ordinance
with the name and place of the main office of the DRA.**



I. Designated Rating Agencies System in Japan

2. Nature of DRAs system

- (1) The objective of the DRAs system is to use, for specific administrative purposes, credit ratings assigned by CRAs which are generally accepted in the Japanese markets.**
- (2) The DRAs system does not give DRAs any special regulatory status.**
- (3) The DRAs system is not regulation or supervision over CRAs.**



I. Designated Rating Agencies System in Japan

3. Use of credit ratings assigned by DRAs in regulations (1)

● For determining regulatory capital requirements

▪ **Capital Adequacy Ratio regulation for banks**

The regulation gives a favorable treatment to the risk weight of qualifying bonds which have designated ratings by DRAs in calculating estimated amounts of market risks.

▪ **Capital Adequacy Ratio regulation for securities companies**

The regulation gives a favorable treatment to risk weights of their assets with designated ratings by DRAs in calculating estimated amounts of market risks and counterparty risks.

▪ **Solvency Margin Ratio regulation for insurance companies**

The regulation gives a favorable treatment to the risk weight of counterparties with designated ratings by DRAs in calculating estimated amounts of credit risks.



I. Designated Rating Agencies System in Japan

3. Use of credit ratings assigned by DRAs in regulations (2)

- **For establishing minimum quality investment standards for financial intermediaries**
 - The regulation restricts insurance companies to invest in assets without designated ratings by DRAs to the specific ratio.

- **For defining investment grade securities**
 - The Banks' Shareholdings Purchase Corporation can purchase, as its special stock purchases scheme, only the stocks of issuers with designated ratings by DRAs.

- **For determining the form and/or content of issuer disclosures**
 - Issuers can use the reference system of the securities registration statement or the shelf registration system for public offerings of corporate bonds if they meet the requirements such as having designated ratings by the DRAs.



I. Designated Rating Agencies System in Japan

4. Current DRAs in Japan

(1) The current DRAs in Japan are set in the FSA Ordinance dated December 22, 2003. The effective term is from January 1, 2004 to December 31, 2005.

(2) There are currently five DRAs.

- Rating and Investment Information, Inc. (R&I)
- Japan Credit Rating Agency, Ltd. (JCR)
- Moody's Investments Securities, Inc. (Moody's)
- Standard and Poor's Credit Market Securities (S&P)
- Fitch Ratings Limited (Fitch)



II. Implementation of Basel II in Japan

1. Schedule

(1) Implementation timeline

- Standardized Approach ⇒ End - March 2007 (End of FY 2006)
- Foundation Internal Based Approach (IRB) ⇒ End - March 2007 (End of FY 2006)
- Advanced Internal Based Approach (AIRB) ⇒ End - March 2008 (End of FY 2007)

(2) Preparation for rules for the new capital adequacy framework

- October 28, 2004 Publication of a consultation paper on draft rules
- March 31, 2005 Publication of revised draft rules
- Around end of 2005 Publication of revised rules in the official gazette

(3) Establishment of Basel II Implementation Office in the Supervisory Bureau in April 2005



II. Implementation of Basel II in Japan

Implementation Timeline in Japan

Applicable Approaches		Y2006				Y2007				Y2008				Y2009				Y2010			
Credit	Ope	End-Mar	Jun	Sep	Dec	End-Mar	Jun	Sep	Dec	End-Mar	Jun	Sep	Dec	End-Mar	Jun	Sep	Dec	End-Mar	Jun	Sep	Dec
SA	BIA or TSA					→				Implementation of Basel II											
FIRB	-	Parallel Calculation				Floor 95%				Floor 90%				Floor 80%				*			
AIRB	AMA	Parallel Calculation				Floor 90%				Floor 80%				*							

(Note) Banks adopting IRB/AMA after year 2008 will be subject to one-year parallel calculation and comparable floors (90% and 80%)



II. Implementation of Basel II in Japan

2. Use of external credit assessment of ECAI (1)

(1) Recognition of ECAI

- Six common eligibility criteria for ECAI (①Objectivity, ②Independence, ③Transparency, ④Disclosure, ⑤Human and Organizational Resources, ⑥Credibility)
- Publication of supervisory process for recognizing ECAI in due course
- Publication of recognition of ECAI and determination of mapping of credit risk assessments into the available risk weights under the standardized approach by the end of March in 2006 when parallel calculation under the IRB approach will start



II. Implementation of Basel II in Japan

2. Use of external credit assessment of ECAI (2)

(2) Implementation considerations

- Publication of the same qualitative and quantitative factors for mapping exercises as Basel II (March 31, 2005)
- Prohibition of use of unsolicited ratings under the Revised Draft Rules
- Making clear under the standardized approach in the Revised Draft Rules that:
 - Banks must establish criteria to use ratings of ECAI
 - Banks must not aim at intentionally reducing credit risk-weighted assets when establishing the criteria;
 - Banks must ensure consistency of the criteria with their risk management purposes