

Tentative translation  
Only Japanese text is authentic

INSPECTION MANUAL FOR FINANCIAL INSTRUMENTS BUSINESS OPERATORS  
(SUPPLEMENT)

INSPECTION MANUAL FOR CREDIT RATING AGENCIES

Executive Bureau, Securities and Exchange Surveillance Commission  
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# I. GENERAL POLICY

## 1. BACKGROUND

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. Credit rating agencies, which determine these credit ratings and broadly publish and provide them to users, play an important role as part of the information infrastructure in financial and capital markets, and they are required to fulfill their functions appropriately.

The objectives of the regulations for credit rating agencies as stated in the Financial Instruments and Exchange Act (hereinafter referred to as “FIEA”) are to make credit rating agencies appropriately exercise their function as part of the information infrastructure, thereby contributing to the sound development of the national economy and the protection of investors.

To achieve these objectives, the Securities and Exchange Surveillance Commission (hereinafter referred to as the “SESC”), which is legally authorized to inspect credit rating agencies, is required to assess the actual business operations of credit rating agencies to check their legal compliance through the inspections. In cases where problems have been discovered, the SESC shall notify such problems to the inspected agency, and, where necessary, request the supervisory authority to take appropriate measures.

The basic policy and procedures pertaining to the SESC’s inspections are in the “Basic Inspection Guidelines” as well as the “Basic Inspection Policy and Inspection Program,” which are prepared each business year (<http://www.fsa.go.jp/sesc/english/index.htm>).

While inspections of credit rating agencies, in principle, shall be conducted in accordance with these basic guidelines and other procedures, the SESC considers that the Inspection Manual, which describes inspection items tailored for each business category, is also practical as a “handbook for inspections” for verifying complex and diverse business operations since the categories of businesses inspected by the SESC vary widely. Accordingly, based on the fact that credit rating agencies have been newly

subject to the inspection by the SESC under the FIEA, the SESC formulated the following “Inspection Manual for Credit Rating Agencies”.

## 2. ON INSPECTION MANUAL

### (1) USE OF THE MANUAL

(i) The Inspection Manual was formulated in order for inspectors to utilize it as a “handbook for inspections.” It is not the sort of manual that automatically or uniformly requires credit rating agencies to accomplish the entries under each of the inspection items contained therein. Accordingly, inspectors shall identify the nature of the business of inspected entities, and thereby conduct suitable verification. Care shall be paid to avoid applying the Inspection Manual in a mechanical and uniform fashion.

Consequently, even in cases where, for instance, a “division” described in the Inspection Manual has not been physically established, rather than judging the credit agency as being unsuitable on account of this alone, it should be kept in mind that a verification is necessary of whether problems may exist, from the view points such as whether the adequate compliance function with laws and regulation is equipped, or whether appropriate organizational structure is well established for internal checks and balances, in keeping with the characteristics, size and other attributes of the inspected agency.

(ii) The Inspection Manual indicates check points just for illustration which might be useful to assess the appropriateness of the inspected agency’s business operations. Accordingly, inspectors shall also verify any other items as necessary to obtain the nature of the agency’s business in relation to its systems and operations.

(iii) Inspectors shall also refer to the “Guidelines for Supervision of Credit Rating Agencies” as well as the Inspection Manual.

(iv) The Inspection Manual was formulated as a handbook for inspectors. However, it can also be useful for inspected agencies to establish or assess their internal systems.

### (2) REPLACEMENT OF TERMINOLOGY

The Inspection Manual has been written basically with a stock company with a board of directors in mind. For credit rating agencies of another form, appropriate omissions and replacements of terms need to be made before using the manual.

### 3. NOTE FOR INSPECTIONS

Inspectors shall pay attention to the following points when conducting inspections of credit rating agencies.

#### (1) ARTICLE 325 OF THE FIB CABINET OFFICE ORDINANCE REGARDING FINANCIAL INSTRUMENTS BUSINESS, ETC. (HEREINAFTER REFERRED TO AS THE “FIB CABINET OFFICE ORDINANCE”)

Inspectors shall take care not to be involved in the individual credit rating or the specific details of the method of credit rating methodologies under Article 325 of the FIB Cabinet Office Ordinance. However, apart from a verification of the appropriateness of the content of an individual credit rating, inspectors are not prohibited from verifying such matters—as whether the due process at the time of the said credit rating being determined have been appropriately taken in accordance with its policies and procedures for determining ratings, by tracing back the history of the individual credit ratings.

#### (2) COOPERATION WITH SUPERVISORY AUTHORITIES

For the purpose of conducting inspections effectively, both “onsite” monitoring by the SESC as an inspection authority and “offsite” monitoring by supervisory authorities need to be properly combined. Authorities shall cooperate with each other while respecting each other’s independence.

Specifically, the SESC is required to conduct an inspection upon sharing information and concerns on the inspected entity with the supervisory authorities which monitor credit rating agencies on an ongoing basis. Furthermore, the SESC is required to inform supervisory authorities of the particular issues as well as the current status identified through the inspection that might be useful for their offsite monitoring, thereby contributing to future administrative supervision.

#### (3) NOTES ON FOREIGN ENTITIES

##### (i) Basic concept of the laws and regulations pertaining to credit ratings determined by foreign entities

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 being introduced for the enhancement of Japan’s capital market and for the protection of investors. Accordingly, credit

ratings without any possibility of being brought into Japan are beyond the scope of the FIEA regulation.

For example, the FIEA regulation does not apply to those credit rating activities related to credit ratings determined by an overseas location of a credit rating agency that is a foreign entity, which satisfy each of the following conditions (“non-Japan-related rating”):

- (a) The rating is not for a financial instrument that is expected to be used for solicitation by financial instruments business operators, etc. in Japan;
- (b) The stakeholders of the credit rating are not domiciled within Japan; and
- (c) In the case of asset securitization products, the main underlying assets are not located in Japan.

On the other hand, a credit rating which is determined in Japan even if it is determined by a foreign entity, is not under the category of a non-Japan-related rating. Therefore, the FIEA regulation will apply to such credit rating.

Furthermore, a foreign entity registered as a credit rating agency under the FIEA shall have policies and procedures to classify their business according to whether or not the FIEA is applied and shall operate in line with such procedures in order to comply with laws and regulations. Inspectors shall verify the appropriateness of the classification (see “6. Notes on Foreign Entities” in II. List of Considerations.).

#### **(ii) Partial exemption from operational control systems**

It should be kept in mind that, under Article 306(6) of the FIB Cabinet Office Ordinance, a foreign corporation registered as a credit rating agency may receive individual exemption from part of its obligation to develop operational control systems, by obtaining the approval of the Commissioner of the Financial Services Agency in cases where certain requirements are met. However, it should also be kept in mind that such exemption will not be given for offices or business sites located in Japan even if the credit rating agency is a foreign corporation.

#### **(iii) Inspection methods, etc.**

With respect to inspections of credit rating agencies that are foreign entities, in principle, onsite inspections will be conducted on their business sites and offices located in Japan. At such times, where necessary, an inspection shall also be carried out of the overseas base of the said foreign corporation, such as by requiring the

submission of materials via the said foreign corporation's business site or office located in Japan.

Furthermore, the SESC shall cooperate appropriately regarding inspections with the authorities in the home country of the said credit rating agency.

## II. LIST OF CONSIDERATIONS

The following is a list of considerations for inspection that may be effective for verifying the appropriateness of a credit rating agency's business during an inspection of the credit rating agency. However, as mentioned earlier, when conducting an inspection, it is essential that inspectors take a flexible approach that bears in mind the characteristics, size, complexity and other attributes of the inspected agency; and take care to prevent too rigid and uniformed verification of items listed in the Inspection Manual.

*Note: For some items, relevant provisions in the FIEA or the FIB Cabinet Office Ordinance are addressed within square brackets. It should be noted, however, that these references can make using this Manual convenient with reference to the relevant law, but such reference does not intend to indicate an interpretation or so forth of the law. Furthermore, with respect to inspection items without any reference provisions mentioned in this Manual, it does not always imply the absence of the relevant legal provisions; and it does not imply that legal provisions not listed as being of reference will not be verified in an inspection, either.*

### 1. BUSINESS MANAGEMENT SYSTEMS

Credit rating agencies shall develop their systems to ensure fairness and appropriateness of the business in order to fulfill their important role as part of the information infrastructure in financial and capital markets. It is essential that senior management shall lead the development of such systems and structures with focusing on compliance of laws and regulations. From this perspective, sustained efforts by the senior management of a credit rating agency are required, including formulating management policies, developing internal control systems and operational control systems consistent with the policies, as well as to assessing and improving the effectiveness of such systems and operations on a timely basis.

During the inspection, the SESC shall verify primarily the following items from the perspective of whether business management systems have been built and, whether the senior management is performing such role.

#### (1) CORPORATE MANAGEMENT POLICY, ETC.



- (i) Does the board of directors give priority to the establishment of corporate ethics based on the fact that credit rating agencies have important social responsibilities in the financial and capital markets; and has it built a structure for the achievement?
- (ii) Does the board of directors regard efforts for legal compliance as the most important issue in corporate management? Has it formulated a basic policy for putting this into practice, and has it made the policy universally known to all officers and employees?

#### (2) CHECKS-AND-BALANCES FUNCTION

- (i) Do directors, in their capacity as members of the board of directors, engage in substantive debate at board meetings and satisfactorily perform their duties of making decisions as well as supervising business execution?
- (ii) Do directors take appropriate actions based on laws and regulations and quickly implement measures necessary for further sound business operations upon discovering violations of laws and regulations committed by other directors or any other employees?
- (iii) Do company auditors attend meetings of the board of directors, and fulfill the oversight function in relation to legal compliance, internal control and other significant matters?

#### (3) CORPORATE MANAGEMENT STRUCTURE

- (i) Does the board of directors recognize the significance of legal compliance, internal control and internal audits, etc., and has it established an appropriate organizational structure sufficient for the nature of the company's business?

#### (4) EFFORTS FOR BUSINESS OPERATION

- (i) Does the board of directors deal with not only matters in relation to business development but also items concerning legal compliance, internal control and other important issues regarding various risks in business operations as a part of the agenda?
- (ii) Has the board of directors developed reporting systems to comprehend the status of business operations?
- (iii) Does the board of directors take the initiative in making efforts to improve problems identified through internal and external audits?

*Note: Efforts to ban any relations with anti-social forces shall be treated in accordance with "II-1-1 1.(6) Efforts for Business Operation" in the Inspection manual for Financial Business Operators.*

**(5) BOARD MINUTES, ETC.**

- (i) Has the board of directors prepared the minutes in a timely manner, and retained them for the statutory period?
- (ii) Have the recorded minutes of board meetings been sufficient to confirm matters reported and the details of approvals given and decisions made at the meetings together with the source documents? Furthermore, have the source documents been kept for the same period of time as the minutes of board meetings?

**2. ESTABLISHMENT OF OPERATIONAL CONTROL SYSTEMS**

In order for a credit rating agency to appropriately operate as a part of the information infrastructure in financial and capital markets, it is essential to develop control systems for executing its business operations in a fair and appropriate manner. For this reason, FIEA requires credit rating agencies to develop operational control systems (Article 66-33 of the FIEA), and the development of such systems is also designated as a requirement for registration (Article 66-30(1)(v) of the FIEA).

Accordingly, inspectors are required to verify the development of operational control systems of credit rating agencies as an important item.

Nonetheless, each credit rating agency shall determine its own specific operational control systems to comply with laws and regulations in accordance with the characteristics, size, complexity and other attributes of its own business. Thus, the following points shall be taken into consideration when conducting verifications of a credit rating agency's operational control systems.

- (1) The inspectors shall verify whether the credit rating agency is actually conducting business consistent with the operational control systems stated in its registration application, etc. In the event it is found that the operation of a credit rating agency is not consistent with the operational control systems stated in the registration application, etc. (for example, in cases where credit rating activities are found that deviate from the agency's internal rules established in terms of the development of operational control systems), the inspectors shall verify its background and decide whether the incident occurred by accident or was caused by some problem with the systems as well as whether the said credit rating

agency is satisfactorily fulfilling its obligation to develop operational control systems.

- (2) Inspectors shall ensure that there is no inappropriate operation which is against the spirit of laws and regulations, even when the credit rating agency is conducting business that consistent with the operational control systems stated in its registration application, etc. In the event that an inappropriate incident is identified, inspectors shall assess whether the said credit rating agency is satisfactorily fulfilling its obligation to develop operational control systems by means of verifying whether its systems work effectively and are reviewed periodically.

In view of the above, inspectors shall verify how operational control systems have been developed with reference primarily to the following items.

(1) MEASURES PERTAINING TO INSTANCES WHERE A PERSON IN CHARGE OF RATINGS 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 [ARTICLE 306(1)(II) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Have records of rating analysts or members of the credit rating committee who are involved in the determination process been appropriately kept? Also, does the credit rating agency check to prevent a lead rating analyst or a member of the credit rating committee, who must not be involved in the rating process prescribed in either (1)(ii)(a) or (b) of the same article, from being involved in the determination of the said rating, such as by making comparisons against the aforementioned records?

Inspectors shall decide lead rating analysts (Article 295(3)(iii) of the FIB Cabinet Office Ordinance), not only by the title, such as “senior” or “chief,” but also being mindful of substance, namely, whether the said analyst has been principally involved in the determination of a credit rating.

(2) MEASURES TO AVOID THE EMPLOYMENT OF PERSONS ABOUT WHOM THERE IS SERIOUS DOUBT IN VIEW OF THE FAIR CREDIT RATING ACTIVITIES [ARTICLE 306(1)(III) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Have policies and procedures for recruiting officers and employees been properly established? In addition, has recruiting actually been conducted in accordance with those policies and procedures?

(3) MEASURES FOR ENSURING THE PROPER BUSINESS OPERATION OF A CREDIT RATING AGENCY [ARTICLE 306(1)(IV) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Have internal control systems for ensuring the appropriateness of the company's business operation been properly developed?

(4) MEASURES FOR ENSURING LEGAL COMPLIANCE [ARTICLE 306(1)(V) OF THE FIB CABINET OFFICE ORDINANCE]

(i) **Efforts of top management**

- (a) Does the board of directors handle violations of law in a fair, equal and firm manner?
- (b) Do systems and methods of business operations appropriately comply with the laws and regulations, etc?
- (c) Does the board of directors, etc. periodically review and improve the effectiveness of measures for legal compliance of a credit rating agency?
- (d) Has the board of directors, etc. provided disciplinary rules to impose strict and fair internal disciplinary actions on those who violated the laws and regulations?

(ii) **Establishment of the chief compliance officer**

- (a) Have appropriate systems and measures been adopted, such as ensuring the independence of the chief compliance officer from the rating and sales divisions, etc. (hereinafter referred to as "sales divisions, etc.") and granting the authority to exercise checks-and-balances functions against the sales divisions, etc.? Does the chief compliance officer appropriately exercise his/her invested authority?
- (b) Does the chief compliance officer endeavor to grasp information on legal compliance, and report necessary information to the board of directors, etc?
- (c) Does the credit rating agency clarify the matters to be communicated, reported and discussed between the chief compliance officer and the sales divisions, etc., as well as the associated methods; and have business operations actually been conducted in accordance with them?

- (d) Has the credit rating agency established internal systems to ensure consolidated management of legal compliance problems as well as relevant internal rules?
- (iii) **Management of legal compliance affairs**
  - (a) In the event the chief compliance officer identifies a problem through verification of the business operations of the sales divisions, etc., does he/she investigate the causes and take necessary actions?
  - (b) Have officers and employees sufficiently been educated by methods such as periodical training?
- (iv) **Formulation of internal rules**
  - (a) Does the CRA within a group company verify its group-wide rules as to whether the rules are appropriate and sufficient by comparing them against Japanese laws and regulations, especially when the rules prepared by an overseas group company are introduced?
  - (b) Do the internal rules clearly require the sales divisions, etc. to conform with the chief compliance officer, etc. in relation to the interpretation of laws, regulations or internal rules, etc.? Do the sales divisions, etc. continue business based on their arbitrary interpretation?
  - (c) Are internal rules revised as necessary in a timely manner in response to amendments to laws and regulations, etc. and in response to changes in the organization or the business operations environment?
- (v) **Implementation plan & code of conduct**
  - (a) Has the implementation plan concerning legal compliance (hereinafter referred to as the “compliance program”) been prepared, approved by the board of directors, etc., and disseminated to officers and employees? In addition, have the authority and responsibilities clearly been granted to the person in charge of following up on the progress and the achievement of the compliance program? Have systems been developed and implemented so that the representative directors and/or other directors can accurately comprehend and evaluate its progress and achievement?
  - (b) Has a code of conduct concerning legal compliance (the “compliance manual”) been prepared, and has its existence and contents been made known to all officers and employees?
- (vi) **Whistle-blowing system**

- (a) Have cases of internal allegations been handled appropriately in accordance with established policies and procedures?
- (b) In response to internal allegations, where necessary, have measures been implemented to prevent a recurrence of similar cases?

*Note: Efforts to ban any relations with anti-social forces shall be treated in accordance with "II-2-1 5. Handling of Antisocial Forces " in the Inspection manual for Financial Business Operators.*

(5) MEASURES PERTAINING TO THE FORMULATION AND IMPLEMENTATION OF POLICIES FOR CONTROL QUALITY IN PROCESSES RELATING TO THE DETERMINATION OF CREDIT RATINGS [ARTICLE 306(1)(VI) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) In order to ensure the adequate quality of information used in determining credit ratings, have policies and procedures for using that information been established? Have ratings actually been determined in accordance with those policies and procedures?
- (ii) Have the validity and effectiveness of the policies and processes for determining ratings been examined in a periodic or timely manner?
- (iii) Have policies and procedures been established concerning the examination and updating of determined credit ratings (excluding cases where it has been decided not to conduct such examinations and updates)? Have actual examinations and updates been conducted in accordance with those procedures?

(6) MEASURES FOR PREVENTING CONFLICTS OF INTEREST RELATED TO THE CREDIT RATING BUSINESS [ARTICLE 306(1)(VII) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Has the credit rating agency specified and categorized conflicts of interest or acts with potential conflicts of interest (hereinafter referred to as "specified acts")?
- (ii) Have measures been properly established, consistent with the characteristics of the specified acts, in order not to prevent the interests of investors?
- (iii) Has it been made known to persons in charge of ratings that they shall not conduct sales, purchases or other transactions of securities, etc. with a potential conflict of interest?
- (iv) Have sales, purchases or other transactions of securities, etc. with a potential conflict of interest been specified and categorized for persons in charge of

ratings (Article 306(1)(vii)(a)1)? Have cases where there is a potential conflict of interest between an officer or employee and a rating stakeholder been specified and categorized (Article 306(1)(vii)(a)2)? In addition, in order for the said officer or employee not to become involved in the rating determination, has a procedure been adopted for confirming that these people do not become involved in a rating determination prior to the rating determination?

- (v) Have measures been taken for examining the validity of the credit rating on a matter in which a rating stakeholder has an interest in cases where an analyst who is no longer an officer or employee has assumed the role of officer of the said rating stakeholder?

(7) MEASURES TO PREVENT ACTS PERTAINING TO ANCILLARY BUSINESS AND OTHER BUSINESS OPERATIONS FROM HAVING AN UNDUE INFLUENCE ON CREDIT RATING ACTIVITIES [ARTICLE 306(1)(VIII) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Consistent with the characteristics of the acts pertaining to ancillary business and other business operations, has the credit rating agency taken measures such as, for instance, administration by the separation of division or separation of the officers in charge?

(8) MEASURES WHEREBY A THIRD PARTY CAN EXAMINE THE VALIDITY OF CREDIT RATINGS PERTAINING TO ASSET SECURITIZATION PRODUCTS FROM AN INDEPENDENT STANDPOINT [ARTICLE 306(1)(IX) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Has the credit rating agency taken consideration of items of information which are deemed important for a third party to assess the validity of a credit rating, so that the content and risks of asset securitization products can be appropriately grasped?
- (ii) Have content, policies and procedures been adopted regarding the approaches to rating stakeholders and the disclosure of the results of those approaches? Have actual approaches and disclosures of results been conducted in accordance with those provisions?

(9) MEASURES FOR ESTABLISHING A POLICY FOR DETERMINING REMUNERATION, ETC., AND FOR ENSURING THAT THE SAID POLICY DOES NOT UNDERMINE THE FAIR AND APPROPRIATE EXECUTION OF ITS CREDIT RATING BUSINESS, ETC. [ARTICLE 306(1)(X) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Has remuneration, etc. been appropriately determined in accordance with the established policy for determining remuneration?

(10) MEASURES FOR PREVENTING PERSONS IN CHARGE OF RATINGS FROM PARTICIPATING IN NEGOTIATIONS FOR THE FEES OF THE SAID CREDIT RATINGS [ARTICLE 306(1)(XI) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) For example, have measures been taken, such as separating the division that conducts the credit ratings from the division that negotiates the fees?
- (ii) Does the credit rating agency clearly prohibit persons in charge of ratings from participating in negotiations for credit rating fees, and has this been made fully known to all officers and employees?

(11) MEASURES FOR APPROPRIATELY MANAGING INFORMATION ACQUIRED DURING THE COURSE OF THE CREDIT RATING BUSINESS AND FOR APPROPRIATELY KEEPING SUCH INFORMATION CONFIDENTIAL [ARTICLE 306(1)(XII) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Does the credit rating agency clearly prohibit the use of information acquired during the course of its credit rating business for purposes other than those for conducting the credit rating business fairly and appropriately, and has this principle been made fully known to all officers and employees?
- (ii) With respect to information acquired during the course of its credit rating business, has the credit rating agency clearly established the scope in which the information is identified as confidential? Has the credit rating agency identified those persons who can acquire the information identified as confidential, such as by setting up rights of access that are restricted to the extent necessary for business? Have those rights of access been strictly administered?
- (iii) Has a system for reporting to the board of directors, etc. and have processes and procedures been established in case an accident occurs such as the leaking or unintended use of information? Has a system that can ensure the rapid measure for such accident been established?

(12) MEASURES FOR DEALING WITH COMPLAINTS AGAINST THE CREDIT RATING AGENCY APPROPRIATELY AND QUICKLY (INCLUDING MEASURES CONCERNING THE DEVELOPMENT OF SYSTEMS FOR REPORTING THE COMPLAINT TO AN OFFICER OF THE



SAID CREDIT RATING AGENCY) [ARTICLE 306(1)(XIII) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Has the credit rating agency set up a contact point for receiving complaints, and has it established the division or person in charge of the business of receiving complaints?
- (ii) Has the credit rating agency established procedures relating to the keeping of records, reporting and processing when a complaint is received? In addition, does the credit rating agency deal with received complaints appropriately and quickly in accordance with those procedures? For example, does the credit rating agency conduct appropriate and swift investigations if a complaint is received which is deemed to require an internal investigation?
- (iii) With respect to complaints that may give a material effect on management, have conditions and systems been adopted that can share information as necessary according to each case, such as by reporting to an officer in a timely manner?

(13) MEASURES FOR PERFORMING THE CREDIT RATING BUSINESS IN ACCORDANCE WITH THE RATING POLICY, ETC. (INCLUDING MEASURES RELATING TO TRAINING FOR RATING ANALYSTS) [ARTICLE 306(1)(XIV) AND 313 OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Does the credit rating agency make the rating policy, etc. universally known by training for officers and employees and other methods?
- (ii) Does the credit rating agency provide the credit rating and make it available for inspection without delay after the determination of the said credit rating (Article 313(3)(i) of the FIB Cabinet Office Ordinance)? Provided that it should be kept in mind that, prior to providing a determined credit rating or making it available for inspection, the credit rating agency is required to adopt methods, etc. which enable the rating stakeholders to check whether there are any factual mistakes (Article 313(2)(iv)).
- (iii) When providing a credit rating or making it available for inspection, are the statutory items (Article 313(3)(iii)(a)-(k) of the FIB Cabinet Office Ordinance) publicized accurately (Article 313(3)(iii))?
- (iv) Have policies been adopted to prevent credit ratings from being determined without complying with the policies and processes for determining ratings,

such as blocking undue approaches made by the officers, employees, etc. of sales divisions toward the process for determining credit ratings?

- (v) Are credit ratings being determined in accordance with the published policies and processes for determining ratings? For example, inspectors shall verify whether credit ratings are determined in accordance with policies and processes for determining ratings with respect to the following perspectives.
  - (a) When determining ratings, are judgments based on a comprehensive account of all collected information pertaining to the credit status of the financial instrument or corporation (Article 313(2)(ii) of the FIB Cabinet Office Ordinance)?
  - (b) 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 said quantitative analysis and the credit rating actually determined, has the difference arisen in accordance with the procedures, etc. contained in the policies and processes for determining ratings (315(1)(i)(f) of the FIB Cabinet Office Ordinance)?
  - (c) For data that is used as the premise of rating determinations, is appropriate data selected in accordance with the policies and processes for determining ratings? Has the credit rating agency engaged in inappropriate acts such as using arbitrary data not based on the policies and processes for determining ratings?

(14) MEASURES FOR PREVENTING FALSE REPRESENTATIONS BEING MADE ABOUT THE GENERAL NATURE PERTAINING TO THE RESULTS OF CREDIT STATUS ASSESSMENTS OF FINANCIAL INSTRUMENTS OR CORPORATIONS AND PREVENTING REPRESENTATIONS WHICH MAY CAUSE MISUNDERSTANDING ABOUT IMPORTANT MATTERS [ARTICLE 306(1)(xv) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Has the credit rating agency made it known to all officers and employees that they are prohibited from making false representations about the general nature pertaining to a credit rating, and making other representation which may cause misunderstanding about important matters?

(15) MEASURES TO PREVENT ACTS FROM BEING MISTAKEN AS ACTS PERTAINING TO THE CREDIT RATING BUSINESS, IN CASES WHERE ACTS PERTAINING TO ANCILLARY

BUSINESS ARE CONDUCTED [ARTICLE 306(1)(XVI) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Has the credit rating agency clearly shown that acts pertaining to ancillary business and acts pertaining to the credit rating business are differently categorized acts?

(16) MEASURES PERTAINING TO THE ESTABLISHMENT OF A SUPERVISORY COMMITTEE [ARTICLE 306(1)(XVII) OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Has the supervisory committee been given the authority for ensuring the appropriateness of the measures listed in Article 306(1)(i)-(xvi) of the FIB Cabinet Office Ordinance? In addition, has that authority and responsibility been clearly established?
- (ii) Has the credit rating agency put in place a human resource system for the supervisory committee to exercise its invested authority properly and to conduct effective supervisory activities?
- (iii) Has the supervisory committee put in place a framework for verifying, based on the viewpoint of independent members, whether the operational control systems of the credit rating agency have been implemented appropriately?
- (iv) Does the supervisory committee report important matters identified during the course of its supervisory activities to the board of directors, etc. without delay? In addition, have reports actually been made without delay?
- (v) Does the supervisory committee appropriately verify the progress of improvements with regard to matters raised by the supervisory committee?

### 3. SYSTEMS FOR THE PREVENTION OF PROHIBITED ACTS

Credit rating agencies are required to develop operational control systems for conducting their business in a fair and appropriate manner. Furthermore, from such perspectives as ensuring independence, preventing conflicts of interest and ensuring the fairness of the rating process, with respect to matters for which that requirement is particularly important, certain acts are prohibited under the laws and regulations because it is considered necessary to make such provision as well as measures based on the development of systems voluntarily made by the credit rating agency. During an inspection as well, the inspectors verify whether any prohibited acts have been committed in the business of a credit rating agency. However, the verification does not finish just upon the acknowledgement of a prohibited act. It should be kept in mind

that the inspectors need to examine what the primary factors were leading up to that act being caused, by tracing back from the event that occurred.

In view of the above, inspectors verify prohibited acts with reference primarily to the following items.

(1) PROHIBITION OF ACTS OF PROVIDING OR MAKING AVAILABLE FOR INSPECTION A CREDIT RATING ON A MATTER IN WHICH THE SAID RATING STAKEHOLDER HAS AN INTEREST IN CASES WHERE A CREDIT RATING AGENCY OR AN OFFICER OR EMPLOYEE THEREOF HAS A CLOSE RELATIONSHIP WITH A RATING STAKEHOLDER, [ARTICLE 66-35(I) OF THE FIEA]

- (i) Has the credit rating agency made it known to all officers and employees that, in cases where a credit rating agency or a person in charge of rating has a “close relationship” with a rating stakeholder, acts of providing a rating or making a rating available for inspection are prohibited?
- (ii) When providing a credit rating or making it available for inspection, does the credit rating agency confirm in advance that the credit rating agency or the person in charge of the rating does not have a “close relationship” with a rating stakeholder?

(2) PROHIBITION OF ACTS OF PROVIDING OR MAKING AVAILABLE FOR INSPECTION THE SAID CREDIT RATING IN CASES WHERE ADVICE HAS BEEN GIVEN TO A RATING STAKEHOLDER ON A MATTER THAT COULD BE EXPECTED TO HAVE A MATERIAL INFLUENCE ON A CREDIT RATING RELATED TO THE SAID RATING STAKEHOLDER [ARTICLE 66-35(II) OF THE FIEA]

- (i) With respect to credit ratings that are provided or made available for inspection, are the details, etc. of the prohibited advice clear so that officers and employees can understand them, and have they been fully communicated?
- (ii) Are records relating to the negotiation process between the person in charge of rating and the rating stakeholder prepared appropriately in accordance with the prescribed rules, etc?

(3) OTHER PROHIBITED ACTS [ARTICLE 312 OF THE FIB CABINET OFFICE ORDINANCE]

- (i) Are the details of acts prohibited by law clear so that officers and employees can understand them, and have they been fully communicated?

(4) PROHIBITION OF NAME LENDING [ARTICLE 66-34 OF THE FIEA]

- (i) Has the credit rating agency made another person engage in credit rating business under the name of the said credit rating agency? For example, when an unregistered credit rating agency which has a capital relationship with a credit rating agency, conducts credit rating activities, does the registered credit rating agency carry out inappropriate acts such as purporting that the credit rating activities were conducted under its own name?

#### 4. INFORMATION DISCLOSURE SYSTEMS

From the perspective of increasing the usefulness of credit ratings for market participants, ensuring the transparency and timeliness of information disclosure pertaining to credit ratings is considered important. Accordingly, during inspections, inspectors will verify whether the credit rating agency's systems for information disclosure are sufficient, with reference primarily to the following items.

(1) DISCLOSURE OF RATING POLICY, ETC. [ARTICLE 66-36 OF THE FIEA]

- (i) Has the rating policy, etc. been disclosed to investors and other credit-rating users in a way that is easy for them to inspect and understand?
- (ii) If the rating policy, etc., is changed, are the details of those changes disclosed in a timely manner? In particular, if a material change is to be made, unless there is any unavoidable reason, does the credit rating agency announce in advance such change and an outline thereof (Article 314(3) of the FIB Cabinet Office Ordinance)?

(2) DISCLOSURE OF EXPLANATORY DOCUMENTS [ARTICLE 66-39 OF THE FIEA]

- (i) Have the matters contained in explanatory documents (Article 318 of the FIB Cabinet Office Ordinance) been stated accurately and in a way that does not cause misunderstanding for investors?

#### 5. INTERNAL AUDIT-RELATED SYSTEMS

Establishing an internal audit division to conduct objective evaluations is considered useful for the purpose of regularly evaluating and improving legal compliance

situation at a credit rating agency. Therefore, in an inspection, the inspectors will primarily verify the following items.

(1) ESTABLISHMENT OF AN INTERNAL AUDIT DIVISION

- (i) Has the board of directors established effective internal audit systems, for example, by setting up a highly independent internal audit division which is free from interference from the sales division, etc., and appointing directors exclusively in charge of that division?
- (ii) Has the board of directors authorized personnel engaged in internal audit operations to obtain all materials considered necessary for the execution of their duties? In addition, has it authorized the personnel to interview and ask questions of all officers and employees considered necessary for executing their duties?
- (iii) On receipt of the results of internal audits, do the representative directors and the board of directors take effective measures for improving problems that could have a material effect on management and problems which are recognized as not being able to be handled by the audited divisions, etc. alone?

(2) HANDLING OF AUDIT PLANS AND AUDIT RESULTS

- (i) Does the internal audit division understand the management of risks in the audited divisions, etc., and has it formulated efficient and effective internal audit plans corresponding to the type and level of risks?
- (ii) Does the internal audit division report any important problems, etc. identified in internal audits to the representative directors and the board of directors without delay?
- (iii) Do audited divisions, etc. improve problems pointed out in internal audit reports without delay, taking into account the level of importance of those problems, and prepare an improvement plan, etc. when needed? In addition, does the internal audit division appropriately review the progress of improvement, and reflect it in the subsequent internal audit plan?

## 6. NOTES ON FOREIGN ENTITIES

As mentioned above (see (3) Notes on Foreign Entities, 3. Points to note in inspections, I. Basic Concept), from the perspective of legal compliance, foreign entities that are

registered as credit rating agencies are required to conduct their business activities after having first clarified which of its credit rating activities are subject to the FIEA and which are not.

Therefore, during an inspection, the inspectors will primarily verify the following items.

- (i) Have specific procedures been established for identifying the scope of credit ratings that are subject to the FIEA, and have business operations been conducted in accordance with those procedures? Also, has the credit rating agency appropriately specified and clarified the credit ratings determined in accordance with these procedures, which are subject to the FIEA?
- (ii) Has the credit rating agency had a system in place for periodically verifying the validity of the scope of credit ratings that are subject to the FIEA?

## 7. OTHERS

A credit rating agency is required to prepare and retain books and documents related to its business in order to contribute to the protection of investors, such as by accurately reflecting the situation of its business and by making it possible to verify the appropriateness of its business, under the law. In addition, the accuracy of statements in business reports is considered an essential element for conducting appropriate administrative supervision.

Therefore, in an inspection, the inspectors will primarily verify the following items with respect to the preparation and preservation of books and documents as well as with respect to the accuracy of business reports.

### (1) PREPARATION AND PRESERVATION OF BOOKS AND DOCUMENTS [ARTICLE 66-37 OF THE FIEA]

- (i) Are statutory books and documents (Article 315 of the FIB Cabinet Office Ordinance), including materials that form the basis for determining a credit rating, prepared and preserved correctly and appropriately so that they can be used for achieving internal control as well as quality control in processes relating to the determination of ratings?

- (ii) In the case of a credit rating agency that is a foreign corporation, is there a system in place whereby books and documents kept at overseas bases can be viewed from a base located in Japan within a reasonable period of time?

(2) SUBMISSION OF BUSINESS REPORTS [ARTICLE 66-38 OF THE FIEA]

- (i) Have statements in business reports been described?