

April 8, 2003
Bank of Japan

Proposal for a new scheme to promote smooth corporate financing by nurturing the asset-backed securities market (Summary)

Intent

- The Bank of Japan proposes to market participants a new scheme to promote smooth corporate financing by nurturing the asset-backed securities market.
- The Bank will, while seeking the views of market participants, review specific arrangements for the case where the Bank would decide to purchase asset-backed securities, including asset-backed commercial papers. The Bank will decide and announce its final decision as soon as possible.

Outline of the proposal

1. Framework of the new scheme and the involvement of the Bank of Japan

(Framework <please see attachment>)

- The Bank of Japan will encourage the new arrangements of asset-backed securities. The asset-backed securities would be backed mainly by pools of assets related to small and medium-sized enterprises (SMEs) classified as “Normal” through banks’ self-assessment process or with equivalent credit standings. Such pools of assets would comprise receivables purchased from SMEs or loans to SMEs. The overall risks of the pooled assets would be restructured into multiple layers representing different degrees of risks.
- For example, the senior and mezzanine tranches would be sold in the markets to investors. Meanwhile, the equity portion would be retained by entities such as originators.

(The Bank of Japan’s involvement)

- The Bank will consider purchasing asset-backed securities of certain credit quality issued through the above scheme. The Bank welcomes other public institutions to join with the Bank in purchasing these securities.

- The purchase of asset-backed securities by the Bank would be a temporary measure against the background of (a) the weak financial intermediary function of Japan's banking sector, and (b) the fact that the asset-backed securities market for SMEs is still in its infancy.

2. Positive effects expected of the introduction of the scheme

- By transferring the credit risk of SMEs to banks, markets (investors) and the public sector, the funding capabilities of companies will be enhanced, while banks' lending capacities will be reinforced.
- Increases the market liquidity of asset-backed securities, thereby reducing funding costs and increasing the availability of funds.
- Paves the way to providing SMEs with a new financing channel, contributing to strengthening the transmission mechanism of monetary easing.

3. Key questions to be addressed by market participants

(General points)

- How strong is the potential need for arranging asset-backed securities? Are market participants interested in the above mentioned scheme? Would there be interest among regional financial institutions in developing such schemes in coordination with other financial institutions?
- How strong is investor demand for asset-backed securities? What are the main factors behind the underdeveloped primary market for mezzanine securities?

(Purchase of a portion of asset-backed securities by the Bank of Japan)

- Would the possible purchases of asset-backed securities of certain credit quality as presented in section 1. by the Bank of Japan improve the corporate financing for SMEs and support the development of the asset-backed securities market? On the contrary, would there be the possibility that such purchases by the Bank or other public sector institutions may distort pricing in these markets?
- Are there government financial institutions that express interest in this scheme? Are there support programs by government financial institutions which could readily be adapted to this scheme?
- What would be a preferable maturity for the securities to be purchased under this scheme?
- What would be a transparent process for pricing such securities which would produce results close to fair value?

(Other issues)

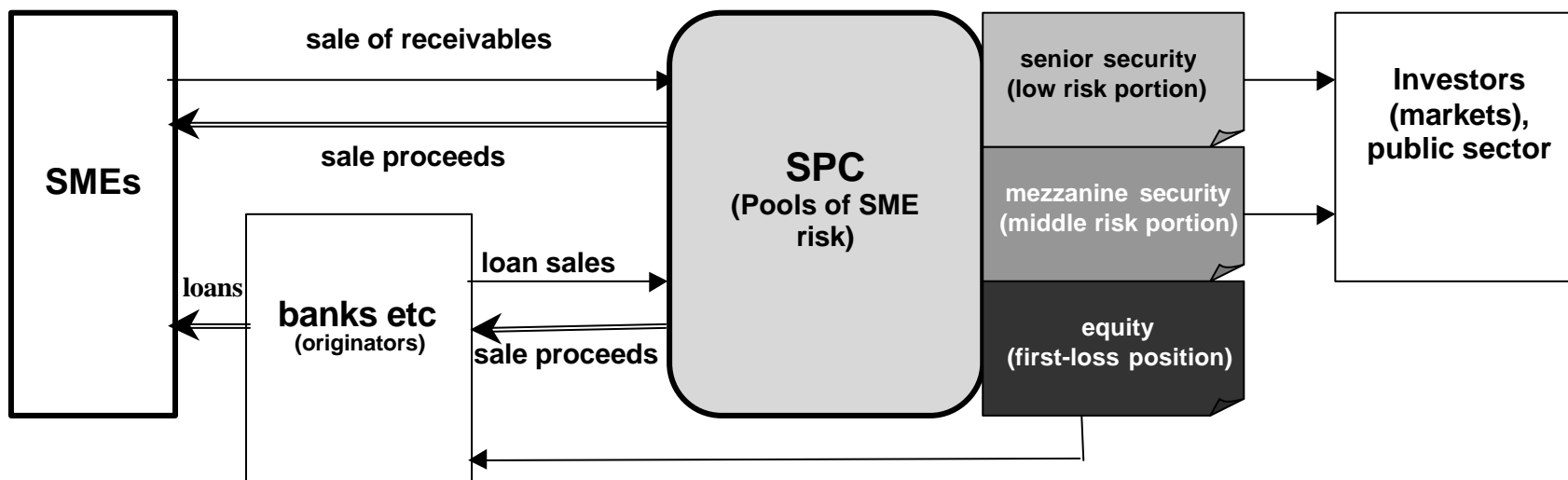
- Are there structural problems (e.g. legal, accounting, tax) or issues related to market practice which could be improved in developing the asset-backed securities markets?

4. Deadline for comments

May 9, 2003 in written format.

(attachment)

Example of the proposed scheme



Note: Depending on the type of security (CPs in the form of bills, short-term corporate bonds, long-term corporate bonds) used within the scheme, the multi-layered structure etc. of the asset-backed security may take various forms.