

# 2012 lakkyara

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**Reducing information gathering and analysis costs  
is the key to revitalizing the securitization market**



Japan's securitization market appears to have finally bottomed, but sustained recovery hinges largely on reduction in the cost of gathering and analyzing information. Achieving this aim will require innovative solutions.

### Has the securitization market finally bottomed?

Securitization is a useful financial tool that essentially enables risk to be dispersed or transformed into a form palatable to investors. It also offers benefits in terms of safety in that principal and interest payments are secured by assets or cash flows.

Until the subprime crisis erupted in 2007, the securitization market was growing briskly even in Japan. In fiscal 2006, securitized product issuance totaled some ¥10 trillion, exceeding corporate straight bond issuance. However, the market shrank dramatically in the wake of the subprime and subsequent financial crisis. In fiscal 2010, domestic securitized product issuance was down to ¥2.6 trillion.

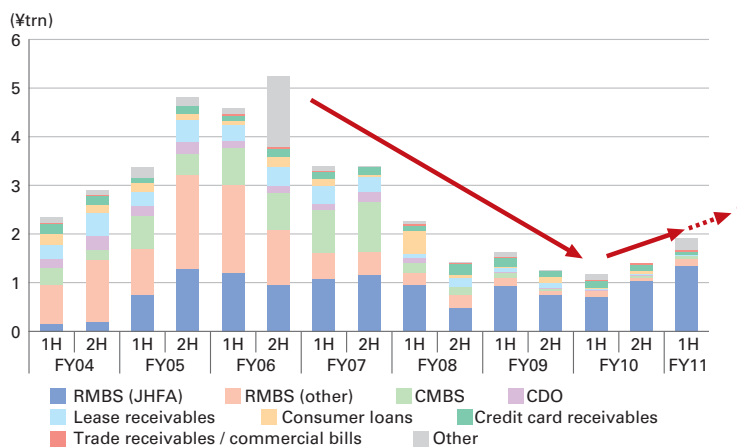
The market appears to have finally embarked on an upturn in fiscal 2011 (see graph). Whether it continues to recover, however, remains to be seen. In fact, the Japanese securitization market's recovery "is undeniably lagging far

behind securitization markets in other countries, including the US," the epicenter of the recent subprime and financial crises, according to a Japan Securities Dealers Association (JSDA) working group<sup>1)</sup>. The working group recommended taking action to revitalize the market.

### Cost of information gathering and analysis is a major factor behind market's slump

Factors behind the securitization market's slump include slower growth in assets available to securitize due to weakness in the real economy and less incentive to use securitization as a means of funding due to increased availability of funds. In addition to these macro factors, a major contributing factor unique to the securitization market is the cost of obtaining and analyzing information for credit risk management<sup>2)</sup>. Gathering and analyzing such information is highly labor-intensive because securitization schemes and covenants are not standardized in Japan in particular, most securitized products are issued in

Exhibit. Securitized product issuance by underlying asset class



Source: JSDA Securitization Market Survey

private offerings, buyers of securitized products tend to be buy-and-hold investors, and there are few observable transactions. In recent years, regulatory authorities have been stepping up regulation of securitized products, including by expanding risk information disclosures and requiring upgrades to risk management systems pursuant to revision of financial inspection manuals. This regulatory tightening will further increase cost burdens. Accordingly, the key to revitalizing the securitization market is to improve efficiency and establish infrastructure in the aim of reducing information gathering and analysis costs.

Through interviews with a number of market participants (institutional investors, brokers, trusts) earlier this year, we have identified three key issues with respect to improving the efficiency and reducing the burden of information gathering and analysis.

The first issue is improving the efficiency of inputting data from various documents. Deal-specific data must be input into computers from product disclosure statements and performance reports that are typically paper-based and prepared in different formats. Because such inputting must be done manually, it entails a heavy workload. It also poses a risk of data entry errors. For these reasons, the market participants we interviewed strongly wish for digital documents with standardized formats.

The second issue is establishing monitoring systems. The predominant means by which data are currently analyzed and managed is spreadsheets, reflecting securitization deals' idiosyncratic nature. Investors have to maintain a large library of spreadsheets to monitor deals on a long-term basis. This approach is undeniably inefficient and poses operational and system risks.

The third issue is augmenting valuation and risk assessment functions. Even some large investors do not possess in-house valuation and risk assessment capabilities and even those that do have such capabilities use deal-specific spreadsheets. Many investors consequently are unable to adequately conduct simulations or stress tests for all of their securitized product holdings.

Initiatives are underway within the industry to address

these issues. In terms of improving data inputting efficiency, the JSDA has developed standard information reporting packages (SIRP)<sup>9</sup>, which standardize reportable data by product category, in the aim of making reports more user-friendly. The JSDA is now preparing guidance on how to use SIRPs for valuation analysis and developing a uniform SIRP format. Given the necessity of migrating to electronic data in the future, industry-wide initiatives will be required to obtain the consent of originators and make requisite arrangements involving report issuers and recipients or information vendors.

### Innovative solutions also needed

Many of those we interviewed felt that the other two issues, developing monitoring systems and augmenting valuation and risk assessment functions, are too difficult to resolve using standardized systems because securitized products are highly idiosyncratic. Other interviewees reported that even though they have purchased a vendor package, the range of products for which it can be used is limited and adding additional products is costly and time-consuming. Surmounting such obstacles will require innovative approaches adapted to securitized products' distinctive characteristics.

One idea is accept that spreadsheets must be used to manage securitized products and develop IT systems configured to encompass spreadsheets. Such systems would comprehensively manage data by storing the data required for monitoring and evaluation, serving the data in a spreadsheet format, and updating the stored data with the information evaluated with the spreadsheet. Constraints (e.g., computing speed) would of course still remain but if they are tolerable, such systems could be a realistic solution.

Another idea is to place priority on enabling management of all types of securitized products with a single system and developing systems that incorporate the flexibility to accommodate highly idiosyncratic data. Such systems would be designed with only universal data entries predefined. Deal-specific data entries would be left undefined, to be added by users. To enable products to be



flexibly added to the system, users should be able to input data terms by setting parameters without having to write code.

Reduction of the cost of information gathering and analysis is an issue that is not unique to securitized products. It is also needed for a broad range of other financial instruments that investors and financial institutions invest in through arrangers, such as syndicated loans and project finance deals. Starting with securitized products, I look forward to future progress in developing infrastructure to facilitate information gathering and analysis.

## Note

1) The quote is excerpted from the working group's July 2011 report, "Japan's securitization market: current state and challenges from the standpoint of market revitalization (issues to be studied by the Securitized Product Working Group)".

2) The aforementioned report cited four factors behind the market's slump: (1) sluggish growth in underlying assets due to weakness in the real economy, (2) increased availability of funding, (3) a widespread perception of securitized products as high-risk and (4) growth in the cost of gathering and analyzing information for credit risk management.

3) SIRPs are currently available for four products: RMBS, ABS, CLO, and CMBS. They contain standardized disclosures to be provided by dealers to investors in disclosure statements published at the time of issuance and subsequent performance reports.

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