

Article Title: ARCHIVE | Criteria | Corporates | General: A Comparison Of Defeasance Transactions In Japan And Those In Other Markets Data: (EDITOR'S NOTE: — This criteria article was retired on Aug. 24, 2016. "Corporate Methodology: Ratios And Adjustments," published on Nov. 19, 2013, paragraph 250, explains how our issuer credit analysis treats bonds under defeasance.) Many Japanese corporations have implemented defeasance transactions since 2000, when the Accounting Standards Board of Japan (ASBJ) codified a particular type of defeasance that can be treated as an off-balance-sheet transaction (hereafter referred to as JGAAP-Eligible Defeasance). In recent years, there has been market interest in JGAAP-Eligible Defeasance, largely due to the following factors: There is little information available on the similarities and differences between JGAAP-Eligible Defeasance and defeasance transactions that are popular in other markets, typically the United States. While Japanese accounting standards allow JGAAP-Eligible Defeasance transactions to be off-balance-sheet transactions, Japanese consumer lender Takefuji Corp. (BBB-/Negative/--) recorded one-time bond losses in fiscal 2007 under a defeasance transaction. Moreover, it has also emerged that the Softbank group might incur losses under a JGAAP-Eligible Defeasance transaction. (For more details, please see the media release titled, "Ratings On Softbank Corp. And WBS-Related Deals Unaffected By Possible Extraordinary Losses", published Oct. 30, 2008). There appears to be limited understanding in the market regarding what would happen if the assets included in a JGAAP-Eligible Defeasance transaction were to deteriorate or if the issuer was to go bankrupt. There seems to be little explicit discussion on whether a JGAAP-Eligible Defeasance bond is insulated from an issuer bankruptcy. Two Separate Questions When analyzing debt defeasance, when in Japan or elsewhere, it is important to address the following two questions: 1. Does the defeasance insulate the defeased debt from an obligor bankruptcy? This question is relevant to the rating on the defeased debt. If the answer is yes, our rating on the defeased debt may generally be de-linked and be as high as 'AAA', subject to other factors such as quality of assets under the defeasance transaction and the legal robustness of the defeasance scheme. If the answer is no, the rating on the debt will generally be linked with the rating on the initial obligor, although a certain notch-up level is typical due to the status of the debt as secured debt and thus the better prospects of recovery than with unsecured debt. 2. Does the defeasance release the obligor from the defeased debt? This question is relevant to defeasance accounting treatment. If the answer is yes, accounting rules in various countries allow the issuer to remove the defeased debt from the obligor's balance sheets (a practice sometimes referred to as "netting"). If the answer is no, such removal is not allowed in many countries. This test appears to be a key concern for many issuers, although our rating analysis generally uses the netting approach for almost all defeased debt even it appears on the relevant financial statements. This is because it is generally highly unlikely for the issuer to be required to pay additional cash. Types Of Defeasance In some countries, it is common to differentiate between legal defeasance and economic (or "in-substance") defeasance. In Japan, almost all recent defeasance transactions have been JGAAP-Eligible Defeasance, which is also referred to as Jisshitsuteki defeasance or trust-type debt assumption defeasance. Although Jisshitsuteki technically means "in-substance", Japanese market participants seldom use the term Jisshitsuteki defeasance to refer to economic defeasance in other countries, but often use it to refer to JGAAP-Eligible Defeasance in Japan. There seems to be a lack of debate and understanding in the market over the similarities and differences between JGAAP-Eligible Defeasance and legal defeasance and economic defeasance in other countries. Table 1 summarizes the key similarities and differences, and a more detailed explanation is provided below. Table 1 Characteristics Of Defeasance Types

	LEGAL DEFEASANCE	ECONOMIC DEFEASANCE	JGAAP-ELIGIBLE DEFEASANCE	NOTES
Defeasance nature provided in initial debt indenture	Yes	No	No	Defeased debt insulated from obligor bankruptcy?
Yes	No	*	If insulated, debt rating de-linked from CCR	Obligor legally released from the defeased debt?
Yes	No	No	If yes, debt can be accounted off the balance sheet	May be removed from balance sheet?
Yes	No	Yes**	Obligor likely to be recoured?	Unlikely Usually unlikely Usually unlikely
If unlikely, netting approach in Standard & Poor's analysis	*See the last section of this report.	**As an exceptional treatment under JGAAP.	As indicated in table 1, JGAAP-Eligible Defeasance has many similarities with economic defeasance in other markets, while a key difference is in the treatment under local accounting standards.	Legal Defeasance Outside Japan
On the one hand, a legal defeasance and a JGAAP-Eligible Defeasance are similar in that the maturities of the trust assets and the defeased				

bonds are largely matched. On the other hand, a legal defeasance in other countries is different from a JGAAP-Eligible Defeasance in that the bond indenture provides for setting up an irrevocable trust that holds high quality assets (normally, U.S. Treasury bonds) sufficient to service the original obligation. This is the most crucial difference from JGAAP-Eligible Defeasance. In a legal defeasance, the trust assets are severed entirely from the issuer. Were the issuer subsequently to file for bankruptcy protection, the trust assets would not be part of the issuer's estate, and there would be no stay on payments from the trust to bondholders. These provisions have been found in municipal bonds and, very rarely, in ordinary corporate bonds. It is not the practice in the Japanese domestic bond market for a bond indenture to provide such a clause. As long as the defeasance is properly consummated, all credit risk associated with the issuer is replaced with the credit risk attached to the assets in the trust. If those assets are U.S. Treasury bonds (as they almost always are), our credit rating on the bond should be 'AAA'. Indeed, if we can verify (through legal opinions) that the defeasance was done properly, the rating on the bond would be upgraded to 'AAA'. However, in practice, such opinions often are not available. This creates an informational limbo surrounding the bonds. In all likelihood, they have been correctly defeased, and deserve to be rated 'AAA'; however, there is no way for us to ascertain this. Given the lack of information upon which we can base a rating, when this situation arises, we discontinue our rating of the bond. The bond's rating status is therefore is Not Rated (NR). Given the complete satisfaction of the issuer's obligations by virtue of such defeasance, the extant bond plays no role whatsoever in the ongoing rating analysis of the issuer's finances. Economic Defeasance Outside Japan Even if not provided in the indenture, the issuer can always set up a trust to service a particular debt issue. In many other countries, this arrangement is often called an economic defeasance, though technically it is not a true defeasance. (Purists would object to referring to the arrangement as defeasance altogether.) There is no legal satisfaction of the original debt; rather, that debt has been transformed into secured debt. Indeed, it would be very well secured, given the excellent collateral in the trust. The trust assets may still be legally entwined with the company, so that payment would be stayed in the event of a corporate bankruptcy, leading to a default. But the bond's recovery prospects are superior. The rating of a bond defeased in this fashion takes into account such enhanced recovery attributes, as with other secured debt. Even if the default risk is not differentiated from that of the issuer, bondholders have better prospects for being made whole in the course of any bankruptcy. Given the quality of the collateral in a defeasance trust, leading to our confidence in presumed full recovery, the defeased bond's rating would be three notches (a full rating category) above the corporate rating. (Under our current criteria, these three notches above the corporate rating represent the maximum enhancement attributable to recovery aspects of a bond.) In notching up, we generally do not require to see full legal opinions, as opposed to the documentation requirements for assigning our 'AAA' rating in the case of legal defeasance. Apart from the higher standard associated with 'AAA' generally, we have greater concern over the many technicalities that are involved in legally defeasing a debt issue. The corporate credit rating also benefits from arranging a defeasance. Whatever accounting may apply, we would net the trust assets and the bond amounts in our financial analysis and ratio calculations. This adjustment reflects the analytical perspective that this debt will be serviced from the trust, rather than corporate cash flow. This treatment is analogous to our netting adjustment for other instances where a company possesses excess cash/liquid assets. JGAAP-Eligible Defeasance Legal background Japan lacks a specific law for debt assumptions, where an entity becomes responsible for servicing a financial obligation of another entity. However, it has been unanimously recognized in Japanese legal circles that debt assumption is legally acceptable in Japan. It is a longstanding practice in Japan to classify debt assumptions into the following three categories. Table 2 Debt Assumption Categories INITIAL OBLIGOR WILL... DEBT ASSUMER WILL... CREDITORS CAN MAKE CLAIMS... Debt service undertaking Remain as the sole obligor. Not become the obligor but will function as the servicer. Against only the initial obligor but not the assumer. Debt participation Remain as one of the co-obligors. Become one of the co-obligors. Against both. Debt takeover Be legally released from the obligation. Become the sole obligor. Against only the assumer but not the initial obligor. It is commonly understood in Japan that both debt participation and debt takeover requires the creditor's approval or agreement to accept the benefit arising from the debt assumption. Therefore, for debt with many creditors, it is not practically feasible to implement either debt participation or a debt takeover. Typical scheme

JGAAP-Eligible Defeasance takes the form of a debt service undertaking, given the aforementioned difficulty in debt participation and debt takeovers. The ASBJ's guidelines allow off-balance-sheet treatment only for bonds and not for other debt. A typical transaction scheme is as follows. 1. The bond issuer enters into a debt service undertaking agreement with a bank, which is usually a bank that plays the role of a bond administrator, if any, for the bond. 2. At the same time, the bond issuer establishes a trust, entrusts sufficient assets, and designates the debt service undertaking bank, not the issuer itself, as a trust beneficiary. 3. The trust invests cash in the trust in high-quality assets that are eligible under the trust agreement. 4. The trust pays trust dividends to the debt service undertaking bank as well as trust principal at the end of the transaction. 5. The debt service undertaking bank uses cash from the trust to service the bond in a timely fashion under the defeasance. Off-balance-sheet criteria A defeasance such as that outlined in the scheme above, or one similar to it, can be treated as an off-balance-sheet transaction under Article 46 of the ASBJ's "Implementation Guidance on Accounting Standards for Financial Instruments" and the ASBJ's relevant Q&A, as an interim exception without any explicit deadline, if it meets certain criteria. The key criteria include the following: (i) The trust is irrevocable. (ii) The eligibility criteria require the assets under the trust to be rated in the 'AA' category or above by more than one rating agency. (iii) The maturity of the assets under the trust largely matches the maturity of the bond. (iv) Even if the bond issuer were to go bankrupt, the bond issuer's creditors would have no rights on the assets in the trust. (v) A scenario in which the bond issuer is required to pay additional cash is extremely unlikely. Takefuji's case In March 2008, Takefuji incurred approximately ¥30 billion in losses from a bond defeasance transaction it implemented in May 2007. The transaction was eligible under the ASBJ's guidelines, and was therefore granted off-balance-sheet treatment in the company's financial statements as of September 2007. It was reported by the media that assets in the trust included CPDOs whose market value had declined to below 10% of the principal amount (i.e., a decline of more than 90%), thereby hitting a trigger that required the liquidation of the transaction and compelling Takefuji to use additional cash to make whole the bond at maturity in 2022. This event showed that a scenario in which the bond issuer was required to pay additional cash (criteria (v) above), was deemed extremely unlikely in May 2007, but eventually turned out to be very likely in March 2008. Softbank Mobile case On Oct. 29, Softbank Corp. (BB/Stable/--) disclosed that the Softbank group may incur losses from a JGAAP-Eligible Defeasance transaction implemented by subsidiary Softbank Mobile Corp. Trust assets are invested in a synthetic CDO, and the number of defaults in the referenced credits has moved closer to a level that would trigger a default of the CDO.

Impact on analysis of issuers When analyzing ratings on issuers, Standard & Poor's generally takes the netting approach for JGAAP-Eligible defeasance, as we do for economic defeasance in other markets (see "Economic Defeasance Outside Japan" above). We would net the trust assets and the bond amounts in our financial analysis and ratio calculations. However, when it becomes likely that the issuer will be required to pay additional cash due to the deterioration of trust assets or due to other reasons, we add back the face value of the bond amount and the economic value of the trust assets (unless already accounted as such), resulting in a negative impact on the issuer rating.

Rating A

JGAAP-Eligible Bond Given that the bond issuer remains the primary obligor, the credit rating on a bond under JGAAP-Eligible Defeasance should not be lower than the rating on the issuer. Instead, it can be higher depending on the following factors: The possibility that the bond will be serviced in a timely fashion even if the issuer goes bankrupt (remoteness from the issuer bankruptcy); The possibility that the bond will be serviced in a timely fashion even if the debt service undertaking bank goes bankrupt (remoteness from the debt servicer bankruptcy), particularly when our rating on the bank is relatively low; and The prospect of post-default recovery in the even of a bond default. Regarding the assessment of a JGAAP-Eligible Defeasance transaction's remoteness from any issuer bankruptcy, our analytical focus would include the following factors: Whether there is a risk that, upon the bankruptcy of the issuer, the bond under JGAAP-Eligible Defeasance would be re-characterized by a bankruptcy court as a secured debt and that, as a result, in a case where bankruptcy proceedings take the form of corporate reorganization, the court enforces a stay on the bond. Whether there is a risk that any delivery of trust assets to bondholders would be voided by a bankruptcy court as preference payments. Determining whether, and the extent to which, the rating on a bond can be higher than the rating on its issuer is a function of our assessment of the factors cited above. We believe that in order to conduct a

reliable assessment of these factors, we need detailed information regarding the defeasance transaction, such as on the profile of the trust assets (including asset eligibility criteria) and legal structure. Such information is not available in the public domain. Accordingly, it is our current practice to withdraw, or to not assign, a rating to a bond under JGAAP-Eligible Defeasance unless we obtain detailed information in an interactive manner. There has been no case to date in which Standard & Poor's has obtained sufficient information and thus rated a bond under JGAAP-Eligible Defeasance. If we were to obtain sufficient information, we would assess the profile of the trust assets (including asset eligibility criteria) and the robustness of the legal structure. The methodology for assessing trust assets would mirror the methodology for assessing defeasance in other markets. We would assess the profile of the asset from all relevant perspectives, such as the amount, credit quality, and maturity matching. Should the profile of trust assets be deemed satisfactory, the focus would be on the legal side. A JGAAP-Eligible Defeasance scheme is meant to insulate bondholders from any issuer bankruptcy. Actually, such bankruptcy remoteness is one of the criteria for allowing JGAAP-Eligible Defeasance transactions to be off-balance-sheet transactions, as mentioned earlier. Ergo, if a JGAAP-Eligible Defeasance bond is off the balance sheet, this means that the auditor of the issuer has concluded that the transaction is remote from an issuer bankruptcy. In Standard & Poor's view, however, the assessment of bankruptcy remoteness is not generally a black-and-white judgment. It is possible that one assessing party would conclude a higher or lower level of bankruptcy remoteness than another. Therefore, even if an auditor allows an issuer to make a JGAAP-Eligible Defeasance bond an off-balance-sheet transaction, Standard & Poor's would still develop its own opinion on the extent of bankruptcy remoteness if we were requested to rate the bond and if we were to obtain sufficient information. Our assessment of the bankruptcy remoteness of JGAAP-Eligible Defeasance transactions may vary by transaction because there are many varieties of legal schemes even within the JGAAP-Eligible Defeasance sphere. Also, should a landmark case occur in which the issuer of a bond under JGAAP-Eligible Defeasance goes bankrupt and we can observe how the bankruptcy court handles the transaction, this could also affect our views. If we conclude that the bankruptcy level is similar to that of typical economic defeasance in other markets, we would take the same approach (i.e. a "notch-up" approach, as we do for economic defeasance in other markets). Alternatively, in order for Standard & Poor's to "de-link" a JGAAP-Eligible Defeasance bond and rate it as high as 'AAA', we would expect to see a similar level of bankruptcy remoteness to that required for legal defeasance in other markets. Note Until 2000, virtually the only type of debt assumption in the Japanese bond market was conventional debt service undertaking (also called conventional debt assumption), where the bond issuer delivers sufficient cash to a bank and the bank undertakes the responsibility to service debt as an agency, but not as an obligor. Either conventional debt assumptions or JGAAP-Eligible Defeasance transactions would not be eligible for off-balance-sheet treatment under U.S. or international accounting standards because the initial obligor remains the primary (or more precisely, the sole) obligor. Until 2000, accounting standards in Japan allowed conventional debt assumptions for off-balance-sheet treatment. However, the accounting rules were changed in 2000 to disallow the off-balance-sheet treatment of conventional debt assumptions. At the same time, the accounting body introduced a temporary exception by allowing off-balance treatment for JGAAP-Eligible Defeasance with certain criteria.