



NEWS RELEASE

November 17, 2005

Rating Transition Matrix for Securitized Products

Rating and Investment Information, Inc. (R&I) has calculated and released its Rating Transition Matrix for securitized products covering fiscal 2000 through fiscal 2004. Not only has it added data for fiscal 2004, but it has also made several minor revisions retroactively in the scope of securitized products subject to the survey.

The revisions are as follows: (1) it has included securitized products that has a senior/subordinate structure which can be divided into two or more tranches. In prior years, the rule for inclusion in the survey was restricted to securitized products that were "credit enhanced" by means of a senior/subordinate structure; (2) it has included the most subordinated portions of securitized products, such as first-to-default credit-linked notes, into the survey.

R&I plans to continue making the performance of its securitized product ratings openly available in the future, while pursuing further refinements to its data consolidation and improvements aimed at providing beneficial investment information based on the characteristics of the securitized products.

By publicly releasing information such as the default ratio for corporate ratings, R&I has sought to disclose rating performance and provide a fundamental building block for the bond market. Although R&I had not been disclosing performance in the form of default rates for securitized product ratings because there have not been any defaults on such products to-date, in June 2003 R&I began releasing the Rating Transition Matrix, limited to just publicly issued ratings for securitized products. In 2004, R&I released a revised version of the Rating Transition Matrix, which expanded the scope of the survey to include non-public ratings.

1 Methodology

1.1 Securitized products covered

- The securitized products covered are: (1) products that have divided the risk of the underlying assets among two or more tranches by means of a senior/subordinate structure; (2) products for which R&I has assigned a long-term issue rating; and (3) those which R&I is monitoring continuously.¹ Guaranteed bonds are not included.
- Of the securitized products covered, those for which R&I has publicly released a rating² are products that had been assigned a rating as of April 1, 1998 and products that were rated between April 1, 1998 and March 31, 2004. Securitized products with a non-public rating include products that had been assigned a rating as of January 1, 2003 and products that were rated between January 1, 2003 and March 31, 2004.

1.2 Criteria for counting the number of rated tranches

- As a rule, R&I considers all of the tranches having a pari passu ranking³, for distribution of the cash flow generated from the same underlying assets to be one tranche when counting the number of rated tranches (the word "tranche" when used below has this same meaning).

¹ Securitized products do not include real estate investment trusts (REITs), but do include Government Housing Loan Corporation bonds.

² In addition to securitized products for which R&I publicly announced at the time as an R&I News Release the fact it had assigned a rating, this also includes those products only described in the rating lists (R&I Quarterly on Bonds & Ratings and the R&I homepage) R&I releases publicly.

³ When there are multiple tranches each of which provides for lump-sum redemption at different maturity and the cash flow from the underlying assets is distributed in order from the tranche with the earliest redemption date, R&I bundles together products whose redemption method is switched to a pass-through when the servicer is replaced and whose cash flow is distributed proportionately in the same order in accordance with the outstanding tranche balances (so-called soft bullet maturity) and counts them as one tranche.

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- The tracking start date⁴ for the tranche rating was assumed to be the issue date or trust execution date⁵, and the tracking expiration date⁶ was assumed to be the date when the outstanding tranche balance was repaid.
- In total there were 712 tranches covered by the survey. This included 346 tranches for which R&I publicly released a rating, and 366 tranches with non-public ratings.

1.3 Rating Transition Matrix calculation method

The Rating Transition Matrix shows how the ratings assigned to a certain tranche have changed over time. R&I calculated the following two different transition matrices by changing the method for setting the observation period.

< Rating Transition Matrix by Fiscal Year >

R&I calculated the ratings of the tranches covered by the survey at each fiscal year-end, then summarized how the rating distribution conditions at the beginning and end of each fiscal year had changed. In the table below, the ratings arrayed in descending order in the left-hand column represent the ratings at the beginning of the fiscal year. The ratings assigned at the end of the fiscal year are in the columns under the rating headings shown in the uppermost row. For example, at the beginning of the fiscal year, there were a total of 49 tranches with a AAA rating. Of these, 45 still had a AAA rating at the end of the fiscal year, none were rated AA+, one tranche was rated AA and so on, with no tranches rated B-, CCC+ or lower. There were also three tranches that had been redeemed. Like the table for the above matrix, the column for redemptions also includes tranches whose outstanding balance was repaid in full prior to the scheduled redemption date for reasons such as early redemption or repayment as a result of purchase.

Fiscal XXXX	AAA	AA+	AA	. . .	B-	CCC+ or lower	Redeemed	Total
AAA	45	0	1	. . .	0	0	3	49
AA+	0	1	0	. . .	0	0	0	1
.
.
B-	0	0	0	. . .	0	0	0	0
CCC+ or lower	0	0	0	. . .	0	0	0	0

< Rating Transition Matrix by Months Passed >

This transition matrix summarizes how the distribution of the ratings for tranches covered by the survey had changed corresponding to the number of months passed since the issue date. In the table below, the ratings arrayed in descending order in the left-hand column represent the ratings on the issue date. The ratings assigned *n* months later are in the columns under the rating headings shown in the uppermost row. The figures in the table show, for example, that among the tranches that were still outstanding *n* months after issuance or that had been redeemed during that period, a total of 198 tranches had been rated AAA when issued. Of these, 182 tranches still had a AAA rating after *n* months, one tranche was rated AA+, one tranche was rated AA and so on. None of these tranches had been downgraded to B- or CCC+ or lower. There were also 14 tranches that had been repaid. Like the table for the above matrix, the column for redemptions also includes tranches whose outstanding balance was repaid in full prior to the scheduled redemption date for reasons such as early redemption or repayment as a result of purchase.

⁴ For issues organized as a master trust, R&I will assign a rating for the new trust beneficial interest whenever new underlying assets are set up on a trust, but when bundling trust beneficial interests that were assigned ratings at different times into a single tranche based on criterion 1.2 above, R&I used the trust execution date for the first trust beneficial interest assigned a rating by R&I as the tracking start date.

⁵ As used here, trust execution date means the date when the trust was executed for the main underlying assets.

⁶ When bundling trust beneficial interests that were assigned ratings at different times into a single tranche based on criterion 1.2 above, R&I used the longest redemption date as the tracking expiration date.

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After <i>n</i> months	AAA	AA+	AA	. . .	B-	CCC+ or lower	Redeemed	Total
AAA	182	1	1	. . .	0	0	14	198
AA+	0	5	0	. . .	0	0	1	6
.
.
B-	0	0	0	. . .	0	0	0	0
CCC+ or lower	0	0	0	. . .	0	0	0	0

2 Survey Results

2.1 Rating Transition Matrix by Fiscal Year

The Rating Transition Matrix by fiscal year is suitable for considering what affect the economic environment in each period had on tranche ratings.

By comparing the rating transition situation for corporate bonds and securitized products using the data for the same fiscal year, we can see that the effect differs even under the same economic environment. Stated simply, compared with corporate bonds, securitized products exhibit a higher stability of the rating. This proved that by their nature the rating stability of securitized products is higher because credit enhancement corresponding to the cash flow characteristics of the specific underlying assets has been provided.

Furthermore, one can see that securitized products have a higher notching difference⁷ when the rating is changed. Most of the downgrading occurred in CBOs backed by corporate bonds from between 10 to 20 issuers, and it is possible to say that the breadth of a downgrade is greater when the underlying assets are less diversified. The upgrade trend which is more influenced by the passage of time since issuance rather than the effect from the economic environment in each fiscal year, is discussed in the following section.

Although only five years of data from fiscal 2000 through fiscal 2004 is used for the time series (see the appendix at the end of this report), the ratings stability generally may be said to be high.

< Mean value of the rating transition percentage by fiscal year for securitized products⁸

(Fiscal 2000 - Fiscal 2004) >

	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B- or lower	Sample size
AAA	99.6	0.3	0.1														767
AA+	6.5	93.5															46
AA	7.0		93.0														43
AA-	2.7			97.3													37
A+	4.5				95.5												22
A	0.4	0.4	0.7			97.0			0.7	0.7							270
A-							96.6		3.4								29
BBB+								100.0									3
BBB	2.0				2.0	2.0			88.2			3.9	2.0				51
BBB-	7.1									85.7			7.1				14
BB+																	
BB												100.0					6
BB-													100.0				5
B+																	
B															100.0		1
B- or lower																	

⁷ The display of a "+" (plus) or "-" (minus) sign after the rating is referred to as "notching," and the difference in the rating class including the notching display is referred to as the "notching difference."

⁸ The value calculated by matching of the matrices for the number of rating transition cases over five years from fiscal 2000 through fiscal 2004 and dividing by the number of total samples over five years.

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< Mean value of the rating transition percentage by fiscal year for corporate bonds

(Fiscal 2000 - Fiscal 2004) >⁹

	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B- or lower	Default	Sample
AAA	79.4	20.6																68
AA+	88.8	9.5	1.7															116
AA	3.3	89.5	7.2															152
AA-		1.5	86.6	9.5	2.5													201
A+		0.6	0.9	88.8	8.4	0.9		0.3										322
A			0.3	3.4	88.1	11.3	1.3	0.5										379
A-				4.6	86.8	6.1	2.2										0.2	538
BBB+					4.7	86.4	7.0	1.3		0.3	0.3							383
BBB					0.3	0.3	6.3	81.1	10.0	1.6	0.3		0.3					380
BBB-		0.3					0.6	5.6	86.6	5.6	0.6	0.3					0.3	321
BB+								3.6	87.4	4.5	3.6						0.9	111
BB							3.1		62.5	15.6	12.5	3.1						32
BB-								2.6		3.1	62.5	15.6	12.5	3.1				39
B+											9.5	66.7	4.8				19.0	21
B											5.9		64.7				29.4	17
B- or lower																		0

2.2 Rating Transition Matrix by Months Passed

After 12 months	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B- or lower	Redeemed	Total
AAA	377																8	385
AA+		18															2	20
AA	1		24														3	28
AA-				22	1												1	24
A+	1				12													13
A	1					177											3	181
A-							16										1	17
BBB+								3										3
BBB						1			22									23
BBB-	1									9							2	12
BB+																		
BB												4						4
BB-													1					1
B+																		
B															1			1
B- or lower																		
Total	381	18	24	22	13	178	16	3	22	9		4	1		1		20	712

Unlike corporate bonds, which are issued by an operating company to raise funds and are backed by the firm's ongoing operations, securitized products are backed by the cash flow generated by specific assets. The credit enhancement level matching that cash flow is evaluated as a rating. Credit enhancement mechanisms vary, but generally changes in securitized product ratings are expected to increase with each passing month because of the tendency for the cash flow and the credit enhancement level to deviate from projections over time.

When we examine the Rating Transition Matrix after 12 months, four ratings had been upgraded to AAA. Two of these actions were exceptions, however, because the agreements covering the underlying assets had been revised substantially. The two other upgrades, and the upgrade from BBB to A, were securitized products backed by non-performing loans that R&I upgraded at an early stage based on excellent collection performance. Basically the cash flow from the underlying assets does not deviate very much from projections during the initial 12-month period, but the collection performance such as non-performing loans, for example, entails a high degree of uncertainty, and the actual value can easily deviate substantially from the initial expectation.

The downgrade from AA- to A+ was a credit-linked note involving a first-to-default swap¹⁰, which R&I downgraded because the rating for one of the multiple credit link entities had deteriorated more

⁹ For a detailed definition of default as used in the tables, see the R&I News Release "R&I Ratings and their Relationship to Default" dated September 30, 2005.

¹⁰ Credit-linked notes involving first-to-default swaps are products where default risk is transferred when the first reference entity among the reference entities defaults.

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than those of the other credit reference entities and increased the probability the securitized product in question would incur a loss.

After 24 months	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B- or lower	Redeemed	Total
AAA	278	1	1														17	297
AA+	1	15															3	19
AA	2(1)		15														5	21
AA-				11													1	12
A+	1				7													8
A	1(1)	1				83			1	1							6	92
A-							11										1	12
BBB+																		
BBB	1(1)								17			1	1				2	21
BBB-	1									2			1				2	6
BB+																		
BB												2					1	3
BB-														1				1
B+																		
B																		
B- or lower																		
Total	282	17	16	11	7	83	11		18	3		3	3				38	492

After 36 months	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B- or lower	Redeemed	Total
AAA	137	1	1														66	205
AA+		8															3	11
AA	3(2)		5														8	14
AA-				5													1	6
A+					2													2
A	2(2)					17			2(1)	2							16	36
A-							4										1	5
BBB+																		
BBB	1(1)								11			2(1)	1				5	18
BBB-													1(1)				3	3
BB+																		
BB																	1	1
BB-																		
B+																		
B																		
B- or lower																		
Total	138	9	6	5	2	17	4		12	2		1	1				104	301

(The number of products for which R&I had changed the rating includes the number of products (shown in parentheses) that had already been redeemed by the number of months passed)

After 24 months and 36 months, a number of instances of rating downgrades accompanying deterioration in the underlying assets can be noted. These were the CBO issues mentioned above, in which the diversification of the underlying assets was comparatively ineffective because it consisted of corporate bonds issued by only 10 to 20 different issuers. When a corporate bond portfolio offers less diversification, the relative value of the credit enhancement level of the tranche is highly susceptible to the negative effects of a deterioration in the creditworthiness of any one security, with results that are reflected in the rating. But because the credit enhancement level rises relatively as the redemption date nears, even for such CBO issues with less diversification ratings are affirmed in many cases despite deterioration of the creditworthiness of the corporate bond underlying assets, and in fact many have been ultimately repaid without incident.

In the case of well-diversified, effective underlying assets, abrupt changes in the performance of the underlying assets is rare, and there have been no actual cases of rating downgrades. Even when performance had deteriorated somewhat, the relative rise in the credit enhancement level over time was sufficient to compensate for the change.



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Under the credit enhancement mechanism, there are tranches for which the credit enhancement level becomes relatively higher over time as well as tranches for which the credit enhancement level remains constant. In general, however, the credit enhancement level will tend to become relatively higher if the performance of the underlying assets remains at the same level as when the tranche was initially issued. The tranches that were actually upgraded extended across a range of products including CMBS, non-performing loans, CDO and ABS. For many of these tranches the cash flow generated by the underlying assets was allocated in order beginning from the highest ranking tranche.



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(Appendix) Rating Transition Matrix by Fiscal Year

Fiscal 2000	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC	CC	C	Redeemed	Total
AAA	45		1																	3	49
AA+		3																			3
AA			1																		1
AA-				1																	1
A+					1																
A						11			1												12
A-							2														2
BBB+								1													
BBB									7					1							8
BBB-										1											
BB+											1										
BB												1									
BB-													1								
B+														1							
B															1						
B-																1					
CCC																	1				
CC																		1			
C																			1		
Total	45	3	2	1		11	2		7	1			1							3	76

Fiscal 2001	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC	CC	C	Redeemed	Total
AAA	90	2																		10	102
AA+		6																			6
AA			4																		4
AA-				3																	3
A+					1																
A						10			2	1										3	16
A-							3														3
BBB+								1													
BBB									10				2								12
BBB-										1				1							2
BB+											1										
BB												1									
BB-													1								1
B+														1							
B															1						
B-																1					
CCC																	1				
CC																		1			
C																			1		
Total	90	8	4	3		10	3		12	2		2	2							13	149

Fiscal 2002	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC	CC	C	Redeemed	Total
AAA	151																			27	178
AA+		9																		1	10
AA			7																	2	9
AA-				4																1	5
A+					2																2
A						17														5	22
A-							2													2	4
BBB+								1													
BBB									11											4	15
BBB-										1										1	2
BB+											1										
BB												1								1	2
BB-													2								2
B+														1							
B															1						
B-																1					
CCC																	1				
CC																		1			
C																			1		
Total	151	9	7	4	2	17	2		11	1		1	2							44	251

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Fiscal 2003	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC	CC	C	Redeemed	Total
AAA	211																			39	250
AA+		14																		4	18
AA	2		12																	2	16
AA-				9																1	10
A+	1				7																8
A	1	1				72														3	77
A-							9														9
BBB+																					
BBB									10											5	15
BBB-	1									2										1	4
BB+																					
BB													2							1	3
BB-														1						2	3
B+																					
B																					
B-																					
CCC																					
CC																					
C																					
Total	216	15	12	9	7	72	9		10	2		2	1							58	413

Fiscal 2004	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC	CC	C	Redeemed	Total
AAA	267																			39	306
AA+	3	11																		2	16
AA	1		16																	3	20
AA-	1			19																	20
A+					12															1	13
A			2			152														9	163
A-							12		1											1	14
BBB+								3													3
BBB	1				1	1			7											3	13
BBB-										8											8
BB+																					
BB													3							1	4
BB-														1							1
B+																					
B																1					1
B-																					
CCC																					
CC																					
C																					
Total	273	11	18	19	13	153	12	3	8	8		3	1		1					59	582

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