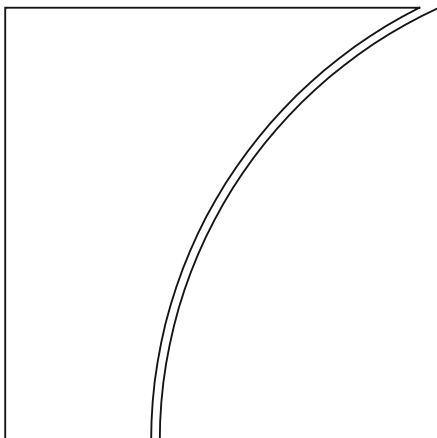


Basel Committee on Banking Supervision



Regulatory Consistency Assessment Programme (RCAP)

Follow-up assessment of Basel III risk-based capital regulations – Japan

December 2016



BANK FOR INTERNATIONAL SETTLEMENTS

Note that this report refers to the RCAP grades prior to October 2025. The grade 'materially non-compliant (MNC)', ie one notch above the lowest grade, has since been renamed to 'partially non-compliant (PNC)' for greater clarity

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Glossary

BCBS	Basel Committee on Banking Supervision
C	Compliant
CET1	Common Equity Tier 1
EAD	Exposure at default
EU	European Union
FAQ	Frequently asked question
FSA	Financial Services Agency
LC	Largely compliant
LCR	Liquidity Coverage Ratio
MNC	Materially non-compliant
NC	Non-compliant
RCAP	Regulatory Consistency Assessment Programme

Executive summary

The Basel Committee on Banking Supervision (Basel Committee) sets a high priority on the implementation of regulatory standards underpinning the Basel III framework. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel framework. The Committee assessed the implementation of its risk-based capital standards in all member jurisdictions between 2012 and 2016.

This report summarises the findings of the RCAP Assessment Team on the domestic adoption of the Basel III loss absorbency and capital buffers standards in Japan. These standards were not assessed during the first assessment of risk-based capital standards in Japan, conducted in 2012, as they had not been implemented at that time. The report of that assessment¹ recommended that these components be assessed in a follow-up assessment. This report describes that follow-up assessment and presents a revised assessment of Japan's overall compliance with the Basel risk-based capital standards. The Japanese regulations implementing these standards were revised in 2012 and 2015 and came into effect in 2013 and 2016.

The focus of the assessment was on the consistency and completeness of the Japanese loss absorbency and capital buffer regulations with the relevant parts of the Basel Committee's minimum requirements. Issues relating to prudential outcomes, the capital levels of individual banks or the supervisory effectiveness of the Japanese authorities were not in the scope of this assessment. The RCAP Assessment Team was led by Mr Luigi Federico Signorini, Deputy Governor of the Bank of Italy. The Assessment Team comprised three experts drawn from Denmark, Malaysia and the United States.

The capital buffers framework in Japan is assessed as largely compliant with the standards. This is one notch below the highest overall grade. The Assessment Team identified four gaps between the Basel buffers framework and the Japanese buffer framework. The Japanese authorities intend to amend their framework in two of these areas by way of forthcoming publications on the process for setting the countercyclical buffer rate and on revisions to bank disclosure requirements.

The loss absorbency requirements are considered to have been implemented in line with the Basel standards. In the Committee's RCAP assessment methodology, these requirements are part of the definition of capital component, the grade for which is now found to be compliant.

The RCAP assessment methodology applies grades both at the level of individual components of the Basel framework and at the overall level of the risk-based capital standards. The Assessment Team considered whether any amendments to the overall grade should be made in light of its assessment. It concluded that, overall, the implementation of the risk-based capital standards in Japan remains compliant. This is the highest overall grade.

The RCAP Assessment Team acknowledges the professional cooperation received from the FSA and the Bank of Japan during the assessment. The Assessment Team is hopeful that the RCAP exercise will contribute to the sound initiatives that have been undertaken in Japan and to strengthening further the prudential effectiveness and full implementation of the Basel risk-based capital standards.

¹ Basel Committee on Banking Supervision, *Basel III regulatory consistency assessment (Level 2) Japan*, October 2012, www.bis.org/bcbs/implementation/l2_jp.pdf.

Response from the Japanese authorities

The Japanese authorities appreciate the opportunity to respond to the findings of the RCAP Assessment Team on the implementation of the Basel III loss absorbency and capital buffers standards in Japan, and highly appreciates the detailed and holistic review conducted by the Assessment Team under the leadership of Mr Luigi Federico Signorini.

We are pleased that Japan has maintained an overall compliant rating as well as a compliant rating for the definition of capital component. We have made our utmost efforts for timely and proper implementation of the Basel III framework into the relevant Japanese regulations and we believe that its effective implementation has contributed to ensuring a more robust regulatory capital framework in Japan.

With regard to the findings pointed out by the team on the countercyclical buffer, we would like to comment as follows:

- Although the reason why interbank exposures should be excluded from the calculation of a countercyclical buffer rate under the Basel framework is not explicit in the Basel III text, the guidance² and the FAQ,³ we researched old documents of Basel III that explain the reason why interbank exposures are excluded. That is to mitigate the possibility of double-counting, since funds are ultimately lent on to other counterparties, which contributes to credit growth. As for exposures to securities firms, taking into account such exposures also ultimately results in double-counting through their financial intermediation function.⁴

Further, Nomura and Daiwa, which are the two largest securities firms in Japan and account for a large portion of the security firms in terms of assets, are treated as “internationally active banks” for the purpose of calculating risk weights under the Pillar 1 Notice.

Therefore, excluding the exposures to the securities firms as well as the interbank exposures should not be a potential material deviation from the Basel framework.

- The amount of specific risk exposures in the trading book is small compared to credit risk exposures. Hence, not implementing an approach for assigning geographic locations to trading book exposures may not be a potential material deviation.

On the whole, the Japanese authorities consider that the RCAP process is a very useful and important measure to ensure consistency and transparency among cross-jurisdictional regulatory frameworks, and facilitates a level playing field among Basel member jurisdictions by reducing regulatory arbitrage as well as promoting soundness and stability in the global financial system. We also support future exercises on an ongoing basis and express our willingness to participate in them.

² Basel Committee on Banking Supervision, *Guidance for national authorities operating the countercyclical capital buffer*, December 2010, www.bis.org/publ/bcbs187.pdf

³ Basel Committee on Banking Supervision, *Frequently asked questions on the Basel III Countercyclical Capital Buffer*, October 2015, www.bis.org/bcbs/publ/d339.pdf

⁴ In particular, there are no rational grounds for differentiating banks and securities firms that conduct investment banking business.

1. Scope of the assessment process

1.1 Introduction

Japan was one of the first countries to be assessed on the implementation of its risk-based capital framework, in 2012.⁵ The Basel III requirements were not required to be implemented until 2013. At the time of the Japanese assessment, the FSA had not implemented rules for capital buffers or the loss absorbency requirements. Therefore, these items were listed for a follow-up assessment.

The FSA is responsible for issuing capital regulations in Japan. More information on the Japanese regulatory system, model of supervision and the nature of prudential regulations is available in the first RCAP assessment report.⁶ The FSA issued regulations on capital buffers in November 2015; these came into effect in March 2016. The loss absorbency requirements were implemented in December 2012 and came into effect in March 2013.

1.2 Assessment methodology and grading

This follow-up assessment followed the Committee's standard RCAP assessment process.⁷ It was conducted alongside the RCAP assessment of the implementation of the Liquidity Coverage Ratio (LCR) in Japan.⁸ The three Basel standards used for this assessment were:

1. *Basel III: A global regulatory framework for more resilient banks and banking systems*, December 2010 (revised June 2011);
2. "Basel Committee issues final elements of the reforms to raise the quality of regulatory capital", Basel Committee press release, 13 January 2011; and
3. *Basel III definition of capital – Frequently asked questions*, December 2011.

The RCAP Assessment Team considered all documents that effectively implement these standards in Japan as of 30 September 2016, the cut-off date for the assessment. The assessment focused on two dimensions:

- A comparison of domestic regulations with the capital standards under the Basel framework to ascertain that all the required provisions have been adopted (*completeness* of the Japanese domestic regulation); and
- Whether there are any differences in substance between the domestic regulations and the capital standards under the Basel framework and their significance (*consistency* of the Japanese regulation).

⁵ The first RCAP assessment of Japan was conducted at the same time as assessments of the European Union and the United States. The EU and the United States were assessed at that time on the basis of draft rules and were assessed again on the basis of final rules in 2014. Japan has not been assessed since 2012.

⁶ Basel Committee on Banking Supervision, *Basel III regulatory consistency assessment (Level 2) Japan*, October 2012, www.bis.org/bcbs/implementation/l2_jp.pdf.

⁷ For more information on the RCAP, see www.bis.org/publ/bcbs264.htm.

⁸ Basel Committee on Banking Supervision, *RCAP Assessment of Basel III LCR regulations – Japan*, December 2016, www.bis.org/bcbs/publ/d391.htm.

Any identified deviation was assessed for its materiality (current and potential, or having an insignificant impact) by using both quantitative and qualitative information. As per the RCAP methodology approved by the Basel Committee, the outcome of the assessment was summarised using a four-grade scale: compliant (C), largely compliant (LC), materially non-compliant (MNC) and non-compliant (NC).⁹ This was applied at the component level for capital buffers. The same scale was used for reviewing the component level grade for the definition of capital and the overall grade for the risk-based capital framework. Ultimately, the assignment of the assessment grades was guided by the collective expert judgment of the Assessment Team.

Importantly, the assessment did not evaluate the adequacy of capital or resilience of the banking system in Japan or the supervisory effectiveness of the Japanese authorities.

2. Assessment findings – component level

2.1 Main findings

Capital buffers

The FSA's implementation of the Basel standards for the capital conservation and countercyclical capital buffers is assessed as largely compliant.

The Assessment Team identified four gaps between the Basel framework and the Japanese implementation of the capital buffers. Two relate to the definition of exposures considered when determining the applicable countercyclical capital buffer rate. A third relates to the process for setting the buffer rate and the notice given to banks. A fourth finding relates to the disclosure of the bank-specific buffer rate. None of these findings are currently material, although they are considered potentially material.

The Japanese authorities informed the Assessment Team that they intend to amend their framework to rectify the latter two findings. These will be addressed in forthcoming publications on the process for setting the countercyclical capital buffer rate and on revisions to bank disclosure requirements.

Loss absorbency requirements

The Japanese implementation of the loss absorbency requirements is in line with the Basel standards. No deviations were identified.

As the loss absorbency requirements form only part of the definition of capital component in the RCAP methodology, no component grade is given here. The effect of the findings on the definition of capital component is considered in the Section 3.

⁹ This four-grade scale is consistent with the approach used for assessing countries' compliance with the Basel Committee's *Core principles for effective banking supervision*. The precise definition of the four grades has been adjusted to take into account the different nature of the two exercises. See www.bis.org/publ/bcbs264.htm for more details.

2.2 Detailed assessment findings on capital buffers only

Component grade	Largely compliant
Summary	<p>The Assessment Team identified four deviations from the Basel standards regarding capital buffers. The team has discussed the materiality of the identified gaps with the authorities, and considers the deviations to be potentially material. These gaps relate to the definition of exposures used in the countercyclical capital buffer, the process for setting this buffer and the disclosure of buffer requirements.</p> <p>Two issues (pre-announcement period and disclosure of countercyclical buffer requirements) remain to be addressed by the authorities. The FSA expects to issue a public notice or to revise Supervisory Guidelines regarding the process and time frame of the pre-announcement period by year-end 2016. Also, the FSA expects to implement the disclosure requirements for the countercyclical capital buffer with future revisions to the Pillar 3 disclosure requirements. As neither of these changes were in effect at the cut-off date of 30 September 2016, they have not been taken into account for this assessment.</p>
Basel paragraph number	141
Reference in the domestic regulation	n/a
Findings	<p>Jurisdictions must pre-announce, by up to 12 months, any decision to raise the countercyclical buffer to give banks time to adjust to the new level. This is not explicit in the Japanese regulations, which only describe the initial setting of the countercyclical capital buffer. Also, the process for adjusting the countercyclical buffer rate is not yet formalised. The countercyclical capital buffer is currently at 0% in Japan.</p> <p>The FSA told the Assessment Team that it intends to set the effective date for any future increase in the buffer rate in line with the Basel rules, ie up to 12 months. It intends to do this by revising Supervisory Guidelines to describe the process for adjusting the countercyclical buffer rate and the pre-announcement period (12 months) for raising the countercyclical buffer. The FSA has initiated internal steps to formalise this process and estimates publication by year-end 2016.</p> <p>As these planned regulations were not in effect by the cut-off date of 30 September 2016, the Assessment Team considered this to be a potentially material deviation from the Basel framework.</p>
Materiality	Potentially material
Basel paragraph number	143
Reference in the domestic regulation	Article 2-2 (4) of the Pillar 1 Notice
Findings	<p>The Basel framework requires internationally active banks to look at the geographic location of their private sector credit exposures (including non-bank financial sector exposures) and calculate their countercyclical capital buffer requirement as a weighted average of the buffers that are being applied in the jurisdictions to which they have an exposure. Credit exposures in this case include all private sector credit exposures that attract a credit risk capital charge or the risk-weighted equivalent trading book capital charge for specific risk, incremental risk charge and securitisation.</p> <p>The Japanese regulations do not clearly define private sector credit exposures or explicitly prescribe the methodology for calculating a standardised risk capital charge based on a regulatory formula. In particular, certain non-bank financial institutions (ie broker-dealers), which should be included in the exposure measure, are treated as "banks" for the purpose of calculating risk weights. This means that they are not taken into account when determining the appropriate countercyclical buffer rate.</p> <p>Also, the regulations refer to sovereign exposure and exposure to financial institutions in calculating credit risk-weighted assets with regard to the countercyclical capital buffer ratio. The Japanese regulations collectively refer to a corporate exposure, sovereign exposure, and exposure to financial institutions as "exposures to corporate and the others". The regulations provide that exposures to corporate and the others are included in the calculation of total credit risk-weighted assets. Q&A (Article 2-2—</p>

	Q.1) stipulates that sovereign exposures and exposure to financial institutions shall be excluded from credit risk-weighted assets. The Assessment Team understands that these exposures are not in fact included by banks when they calculate their buffer rate. Although this deviation is not currently material, with most countries' countercyclical capital buffer rates at zero and relatively low exposures of banks to such firms, this could become material in the future if buffer rates rose or exposures increased.
Materiality	Potentially material
Basel paragraph number	145
Reference in the domestic regulation	n/a
Findings	<p>The Basel framework expects banks and supervisors to develop an approach for allocating geographic locations to specific risk exposures in the trading book. The approach should translate charges for specific risk into individual instrument risk weights for allocation to the geographic locations of specific counterparties. However, if charges are calculated on a portfolio-by-portfolio basis, the charge for the relevant portfolio should be allocated to the geographic regions of the constituents of the portfolio by calculating the proportion of the portfolio's total exposures at default (EAD) that is due to the EAD resulting from counterparties in each geographic region.</p> <p>The Japanese authorities have not implemented an approach for assigning geographic locations to trading book exposures. The FSA provided data illustrating the countercyclical buffer calculation as of 31 March 2016. The results indicate that there is currently minimal difference in the countercyclical buffer ratio considering credit exposure with specific risk versus without specific risk. The results also reflect minimal difference in the countercyclical buffer ratio considering aggregate credit exposure and specific risk.</p> <p>The FSA commented that the amount of specific risk exposures in the trading book is small compared to credit risk exposures. The data provided by the FSA suggest that the impact of the deviation on risk-weighted assets and the buffer ratio is limited for the time being. However, the Assessment Team considers that with most countries' countercyclical capital buffer rates at zero, the deviations could become material in the future if buffer rates rose or exposures increased significantly.</p>
Materiality	Potentially material
Basel paragraph number	149
Reference in the domestic regulation	n/a
Findings	<p>Under the Basel framework, banks must disclose their countercyclical capital buffer requirement. This aims to make the countercyclical capital buffer easier to interpret and to enhance its credibility. This requirement has not been implemented in Japan.</p> <p>As the countercyclical capital buffer rate is currently 0% in Japan, Japanese banks have limited exposures to jurisdictions with positive rates and country rates are publicly available, the Assessment Team considered this finding not to be material at the moment. However, the deviation could become material in the future if buffer rates rose or exposures increased significantly.</p> <p>The FSA told the Assessment Team that they expected to implement the requirement with future revisions to the Pillar 3 disclosure requirements. As this requirement was not in effect by the cut-off date of 30 September 2016, it has not been taken into account for this assessment.</p>
Materiality	Potentially material

2.3 Observations specific to implementation practices in Japan

The following list describes the observations of the Assessment Team regarding Japan's implementation of the capital buffers and loss absorbency requirements. These observations are consistent with the Basel framework and are provided here for background information only.

The FSA has not adopted any approach for capital buffers or loss absorbency requirements that is stricter than the minimum standards prescribed by the Basel Committee.

Capital buffers

Basel paragraph number	132(d)
Reference in the domestic regulation	None
Observation	<p>Under the Basel framework, supervisors must have the power to impose time limits on banks operating within the buffer range and must ensure that banks establish capital plans to re-build buffers over an appropriate time frame. The Japanese regulations include provisions on the general recovery of capital ratios, but do not address the specific situation where banks are operating within the buffer or define a time frame to rebuild the buffer.</p> <p>The FSA explained that legislative powers are available to require banks to rebuild their capital positions within a specific time frame. If a bank submitted a recovery plan to rebuild the buffer with an unreasonable time frame (or without a time frame) considering the specific situation of the bank, the FSA would require the bank to resubmit the plan with an appropriate time frame. If the bank does not comply, the FSA would take necessary measures including a business suspension order based on the Banking Act.</p>
Basel paragraph number	133 and 150
Reference in domestic regulation	Supplementary Provisions of the Pillar 1 Notice
Observation	<p>The Basel framework phases in the capital buffers between 1 January 2016 and year-end 2018, becoming fully effective on 1 January 2019.</p> <p>The Japanese framework phases in the buffer requirements between 31 March 2016 and 31 March 2019. This reflects the Japanese financial year, which starts on 1 April. As in the RCAP Capital assessment for Japan, this difference in the timing of implementation has not been considered a deviation from the Basel framework.</p>

Loss absorbency requirements

Basel paragraph number	Press Release Annex 1
Reference in domestic regulation	<p>Article 6(4)(xi) of the Pillar 1 Notice</p> <p>III-2-1-1-3(2)(iv)(c) of Supervisory Guidelines</p>
Observation	<p>The FSA has adopted a contractual approach regarding the terms and conditions of all Additional Tier 1 and Tier 2 instruments, rather than relying on statutory powers. The FSA regulations stipulate that all instruments must include special provisions for the write-off of the principal or conversion into common shares. Further, the regulations stipulate that, where there is a special provision concerning conversion into common equity, supervisors should examine whether it meets all of certain criteria, including that an appropriate minimum conversion value has been set and that the total amount of authorised shares has been determined in the articles of incorporation.</p> <p>The FSA provided that, while regulations indicate a discretionary choice between a provision concerning principal reduction or conversion into common shares, there are no instruments with a point-of-non-viability clause (PONV) stipulating conversion to</p>

	equities. All instruments shall be written-off at the PONV. The FSA has not stipulated procedures for determining the appropriateness of minimum conversion values.
Basel paragraph number	Transitional arrangements
Reference in domestic regulation	III-2-1-1-3 Supervisory Method and Actions of Supervisory Guidelines Supplementary Provision of the Pillar 1 Notice Article 3
Observation	<p>The Basel framework phases out instruments that do not meet the loss absorbency requirements between 1 January 2013 and 1 January 2022. In Japan, this transitional period runs between 31 March 2013 and 31 March 2022. As in the observation on capital buffers above, the difference in effective dates between 1 January and 31 March, which reflects the Japanese financial year, is not considered to be a deviation from the Basel framework.</p> <p>The transitional arrangements in the Basel framework apply to instruments issued before 12 September 2010. Instruments issued thereafter do not qualify for these arrangements. In Japan, the Pillar 1 Notice implements the Basel transitional arrangements for capital instruments issued before 12 September 2010. However, transitional arrangements for instruments issued between 12 September 2010 and 30 March 2013 are not clear in the Japanese regulations.</p> <p>The FSA clarified that instruments issued before 12 September 2010 are subject to the transitional arrangements of Basel II paragraph 94(g). Instruments issued between 12 September 2010 and 31 March 2013 are subject to the Basel Press Release transitional arrangements for loss absorbency requirements.</p> <p>The FSA provided that, at the time of publication of the revised Pillar 1 Notice, there were no Tier 1 instruments issued that were subject to phase-out in accordance with the Basel Press Release. There were no newly issued instruments by the application date. Hence, the Japanese authorities did not publish transitional arrangements for such instruments. However, Tier 2 instruments were issued during this period, which are subject to the Basel Press Release transitional arrangements (as described above). The FSA provided a list of all such outstanding Tier 2 instruments.</p>

3. Effect on assessment of overall risk-based capital standards

3.1 Reviewing the definition of capital component grade

Many parts of the Basel III definition of capital were assessed in 2012. At that time, and noting that the loss absorbency requirements had not yet been introduced, the Assessment Team assigned a provisional grade of (LC) for this component. Apart from the absence of loss absorbency requirements, the 2012 RCAP identified three findings, none of which were considered material.

The current RCAP assessment did not revisit those three findings, or other parts of the definition of capital assessed in 2012. As there are no findings on the implementation of the loss absorbency requirements and only three immaterial findings remaining for the definition of capital component, the Assessment Team considered that this component should now be assessed as compliant.

3.2 Reviewing the overall grade

Table 2 summarises the RCAP assessment grades for the Japanese risk-based capital framework. This covers all components from the first RCAP assessment in 2012, as well as the assessment of capital buffers and loss absorbency requirements described in this report.

This assessment assigned one new component grade (for capital buffers) and raised one other component grade (definition of capital). No other component has been re-assessed. On this basis, the Assessment Team saw no reason to change the overall grade of compliant.

Summary of assessment grades

Table 1

Key components of the Basel capital framework	Previous grade	Current grade
Overall grade	C	C
Scope of application	C	C
Minimum capital requirements and transitional arrangements	C	C
Definition of capital	(LC)	C
Pillar 1: Minimum capital requirements		
Credit risk: Standardised Approach	C	C
Credit risk: Internal Ratings-Based Approach	C	C
Securitisation framework	LC	LC
Counterparty credit risk framework	C	C
Market risk: Standardised Measurement Method	LC	LC
Market risk: Internal Models Approach	C	C
Operational risk: Basic Indicator Approach and Standardised Approach	C	C
Operational risk: Advanced Measurement Approaches	C	C
Capital buffers (conservation and countercyclical)	Not yet assessed	LC
Pillar 2: Supervisory review process		
Legal and regulatory framework for the Supervisory Review Process and for taking supervisory actions	C	C
Pillar 3: Market discipline		
Disclosure requirements	C	C
Compliance assessment scale (see Section 1.3 for more information on the definition of the grades): C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).		

Annex 1: RCAP Assessment Team and Review Team

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Mr Muhammet Salih Ağan	Banking Regulation and Supervision Agency of Turkey
Mr Alexandre Kurth	Swiss Financial Market and Supervisory Authority

Annex 2: Local regulations issued by Japanese authorities for implementing Basel capital buffer and loss absorbency standards

Overview of relevant Japanese capital rules and issuance dates		Table A.1
Domestic regulations	Version and date	
Banking Act	Implemented in June 1981 and revised subsequently (most recently in June 2014)	
FSA Administrative Notice on Capital Adequacy Rules pursuant to Article 14-2 of the Banking Act	Revised in November 2015	
FSA Administrative Notice on Capital Adequacy Rules pursuant to Article 52-25 of the Banking Act	Revised in November 2015	
Order Specifying the Categories etc Prescribed in Article 26 paragraph (2) of the Banking Act	Revised in November 2015	
Q&A	Revised in 2016	
Supervisory Guidelines	Supervisory Guidelines for Major Banks, amended in March 2015	
Source: FSA.		

Additional information on the hierarchy of Japanese laws and regulatory instruments and their binding nature is included in the previous RCAP assessment report and Annex 5 of the RCAP-LCR assessment of Japan.¹⁰ This RCAP Assessment Team concluded that the regulatory instruments set out above are eligible for the RCAP assessment.

¹⁰ Basel Committee on Banking Supervision, *Basel III regulatory consistency assessment (Level 2) Japan*, October 2012, www.bis.org/bcbs/implementation/l2_jp.pdf and *RCAP Assessment of Basel III LCR regulations – Japan*, December 2016, www.bis.org/bcbs/publ/d391.htm.

Annex 3: Rectifications planned by the Japanese authorities

List of rectifications planned by the Japanese authorities

Capital buffers

Table A.2

Basel paragraph	Reference to Japanese document (subject to change)	Description of the forthcoming rectification
141	Supervisory Guidelines	Revisions will address the process for adjusting the countercyclical capital buffer and the pre-announcement period (12 months) for raising the countercyclical capital buffer.
149	Pillar 3 Notice	The FSA intends to implement the countercyclical capital buffer disclosure requirements at the same time as the Basel Committee's revised Pillar 3 framework (published in January 2015).

Annex 4: Materiality assessment

The outcome of the RCAP assessment is based on the materiality of the findings. These were assessed with respect to a sample of Japanese banks (see Table A.3). Together, these banks hold around 90% of the banking sector assets and off-balance sheet items of those Japanese banks that are internationally active.

RCAP sample banks Table A.3

Banking group	Share of banks' assets in the total assets and off-balance sheet items of internationally active Japanese banks (per cent)
Mitsubishi UFJ FG	29.5
Mizuho FG	18.9
Sumitomo Mitsui FG	18.7
Norinchukin	9.8
Sumitomo Mitsui TH	5.8
Nomura	5.7
Daiwa HD	1.8
Total	90.1

Source: FSA. The sample of banks is agreed between the Japanese authorities and the Assessment Team.

In terms of risk-weighted assets, internationally active banks comprise 65% of the Japanese banking system. The RCAP sample banks comprise 55% of the risk-weighted assets of the Japanese banking system.

The Assessment Team attempted to quantify the impact of all quantifiable gaps on the sample banks. Materiality was assessed with reference to reported capital ratios (CET1, Tier 1 or total capital, as appropriate). In cases where such computation was not straightforward, the computation erred on the conservative side. Where no data were available to quantify gaps, the Assessment Team relied on expert judgment. Following this approach, the Assessment Team determined whether gaps were likely to be "not material", "potentially material" or "material".

Number of gaps by component Table A.4

Component	Not material	Potentially material	Material
Capital buffers	0	4	0
Definition of capital	3	0	0
of which:			
Loss absorbency requirements (this assessment)	0	0	0
Other rules (previous assessment)	3	0	0