Basel Committee
on Banking Supervision

Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel NSFR regulations – Japan

September 2022

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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Contents

Glossary

BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
C	Compliant (grade)
ECB	European Central Bank
D-SIB	Domestic systemically important bank
FAQ	Frequently asked question
JFSA	Japanese Financial Services Agency
G-SIB	Global systemically important bank
JPY	Japanese yen
LC	Largely compliant (grade)
LCR	Liquidity Coverage Ratio
MNC	Materially non-compliant (grade)
NC	Non-compliant (grade)
NSFR	Net Stable Funding Ratio
RCAP	Regulatory Consistency Assessment Programme

Preface

The Basel Committee on Banking Supervision (Basel Committee) places a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented fully, consistently and in a timely manner by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel framework.[1]

This report presents the findings of an RCAP Assessment Team on the adoption of the Basel Net Stable Funding Ratio (NSFR) standard in Japan. The assessment focused on the completeness and consistency of the Japanese regulations with the Basel NSFR standard and relied on translated regulations and information provided by the Japanese authorities.

The assessment began in September 2019 but was suspended in March 2020 due to Covid-19.[2] The assessment resumed in December 2021 with an Assessment Team led by Mr Daniel Perez, Director of the Regulation Department at the Bank of Spain and comprising four technical experts, from Hong Kong SAR, ECB Banking Supervision, Turkey and the United Kingdom (see Annex 1). The main counterparts for the assessment were Japanese Financial Services Agency (JFSA) and the Bank of Japan. The work was coordinated by the Basel Committee Secretariat with support from staff from the Bank of Spain.

The assessment comprised (i) a self-assessment by the Japanese authorities; (ii) an assessment phase; and (iii) a review phase including a technical review of the Assessment Team's findings by a separate RCAP Review Team. The assessment report ultimately reflects the view of the Basel Committee.

The Assessment Team acknowledges the cooperation received from the JFSA and Bank of Japan throughout the assessment process.

[1] See www.bis.org/bcbs/implementation.htm.

[2] See www.bis.org/press/p200320.htm.

Executive summary

In Japan, the draft definition and draft specifications of the NSFR were introduced first through the Draft FSA Administrative Notice on the liquidity ratio requirements for internationally active banks pursuant to the provision of Article 14-2 of the Banking Act. In addition, the draft NSFR disclosure standards were introduced first through the Administrative Notice on the disclosure of liquidity ratio requirements for internationally active banks pursuant to the provision of Article 19-2, paragraph (1), item (v), sub-item (e) of the Ordinance for Enforcement of the Banking Act. The final rules were finalised by the JFSA, issued on 31 March 2021 and are effective from 30 September 2021, over three years after the Basel Committee's agreed implementation date of January 2018.

As of 30 June 2022, the NSFR regulations in Japan are assessed as compliant with the Basel NSFR standard. Three out of the four components of the Basel NSFR standard are assessed as compliant (scope, minimum requirements and application issues; available stable funding (ASF); and disclosure requirements) whereas the component of required stable funding (RSF) is assessed as largely compliant.

The Assessment Team identified three non-material deviations under Japanese regulations with respect to (i) the RSF factor applied to unencumbered Level 1 securities; (ii) the RSF factor applied to unencumbered short-term (< six months) secured lending transactions backed by Level 1 assets; and (iii) the scope of variation margin received that may offset derivative assets.

The Assessment Team also identified some observations, with two of them relating to issues on which further guidance will be sought from the Basel Committee, namely the treatment of excess collateral posted as variation margin in relation to derivative liabilities as well as the eligibility of derivative transactions associated with client clearing activities as interdependent assets and liabilities.

The Japanese authorities have adopted a stricter approach than the Basel NSFR standard prescribed by the Basel Committee in relation to the treatment of excess cash collateral received as variation margin in relation to derivative assets. Specifically, unlike the Basel NSFR standard, under the Japanese regulation, excess eligible variation margin received is not permitted to effectively offset uncollateralised derivative assets in other transactions/netting sets ("portfolio-based offsetting").

Response from the Japanese authorities

The JFSA and the Bank of Japan thank the Assessment Team led by Mr Daniel Perez for their professional work throughout the assessment process. We appreciate, in particular, that the Assessment Team worked diligently during the pandemic and with the new format of full remote assessment. The constructive discussion throughout the evaluation process provided a valuable opportunity for us.

We welcome the team's overall evaluation that the NSFR framework in Japan is compliant with the Basel NSFR framework. We also agree with the assessment of the Required Stable Funding component as largely compliant. We note that all of the non-material findings identified by the assessment team are due to adjustments we made, with careful consideration, to ensure the continued smooth functioning of the Japanese financial markets and to maintain a level playing field vis-à-vis other jurisdictions introducing similar adjustments. We have made our utmost efforts for the timely and proper incorporation of the NSFR framework into relevant Japanese regulations. We believe that the effective implementation of NSFR has contributed to ensuring more robust liquidity risk management and supervision.

We believe the RCAP is a very useful and important instrument to ensure consistency and transparency among cross-jurisdictional regulatory frameworks. We also support and express our willingness to participate in future assessments.

1 Assessment context

1.1 Regulatory system

The JFSA is the main regulatory and supervisory authority for banks in Japan. It was established in 1998 as an administrative organ of the Prime Minister's Office, responsible for the inspection and supervision of private sector financial institutions and the surveillance of securities transactions. In January 2001, the JFSA became an external organ of the Cabinet Office and took over responsibility for resolving failed financial institutions. The JFSA is now responsible for ensuring the stability of the financial system; protection of depositors, insurance policyholders and securities investors; and smooth intermediation, through such measures as planning and policymaking concerning the financial industry and market; and inspection and supervision of private sector financial institutions.[3]

The Bank of Japan carries out monetary policy and is responsible for financial stability and the effective settlement of financial transactions. It conducts on-site examinations and off-site monitoring of its counterparty financial institutions, in the context of its central banking functions. This includes the large Japanese banks. Its supervisory powers are grounded on individual contracts with its counterparties, based on Article 44 of the Bank of Japan Act.

The JFSA's supervisory practice is governed by the Banking Act, which provides for JFSA independence in day-to-day bank supervision. Under the Banking Act, the JFSA may issue Notices. The JFSA also issues Q&As and Supervisory Guidelines. Regulation constitutes fully binding formal rules. Although the other documents are less formal in nature, they are publicly available and banks are expected to comply with them. As in the previous assessment of the implementation of the Basel risk-based capital standards and the LCR in Japan,[4] the Assessment Team finds that the NSFR regulations in Japan meet the RCAP criteria of being enforceable and binding in practice.

1.2 Status of NSFR implementation

In October 2014, the JFSA issued an Administrative Notice on Liquidity Coverage Ratio for internationally active banks pursuant to the provision of Article 14-2 of the Banking Act (hereafter, the "Pillar 1 Notice"). In June 2018, the JFSA issued the Draft FSA Administrative Notice updating the liquidity ratio requirements for internationally active banks pursuant to the provision of Article 14-2 of the Banking Act. This Notice introduced the definition and specifications of the NSFR. At the same time, the JFSA also issued the Administrative Notice on the disclosure of liquidity ratio requirements for internationally active banks pursuant to the provision of Article 19-2, paragraph (1), item (v), sub-item (e) of the Ordinance for Enforcement of the Banking Act (hereafter, the "Pillar 3 Notice"), through which the NSFR disclosure standards were to be introduced. The final rules were issued on 31 March 2021 and are effective from 30 September 2021. They are complemented by JFSA Supervisory Guidelines and Q&As, which address more detailed points of interpretation. For more detail on the legislation issued, see Annex 2.

[3] The Securities and Exchange Surveillance Commission, responsible for market surveillance and inspections of securities companies, and the Certified Public Accountants and Auditing Oversight Board, responsible for overseeing quality review work performed by the Japanese Institute of Certified Public Accountants, are also within the FSA, although they have different powers to those used for bank regulation and supervision.

[4] Basel Committee on Banking Supervision (BCBS), Basel III regulatory consistency assessment (Level 2): Japan, www.bis.org/bcbs/implementation/l2_jp.pdf (October 2012), www.bis.org/bcbs/publ/d392.pdf (December 2016) and www.bis.org/bcbs/implementation/l2_jp.pdf (December 2016).

1.3 Scope of the assessment

The Assessment Team considered the NSFR requirements applicable to commercial banks in Japan as of 30 June 2022. The assessment had two dimensions:

- a comparison of domestic regulations with the Basel NSFR standard to ascertain that all the required provisions have been adopted (*completeness* of the regulations); and
- whether there are any differences in substance between the domestic regulations and the Basel NSFR standard and, if so, their significance (*consistency* of the regulations).

In its assessment, the RCAP Assessment Team considered all binding documents that effectively implement the Basel NSFR standard in Japan. Annex 2 lists the Basel standards used as the basis for the assessment. The assessment did not evaluate the adequacy of funding or the resilience of the banking system in Japan or the supervisory effectiveness of the Japanese authorities.

The Assessment Team evaluated the materiality and potential materiality of identified deviations between the Basel NSFR standard and the Japanese regulations. The evaluation was made using a sample of five internationally active banks in Japan. Together, these banks comprise about 82.84% of the assets of internationally active banks in Japan. As of end-September 2021, there are 112 banks in Japan, of which 19 are internationally active. Internationally active banks are defined as banks that have one or more branches or subsidiaries outside Japan. Annex 3 lists the key liquidity indicators of the Japan banking system and the sample of banks. In addition, the Assessment Team reviewed the non-quantifiable aspects of identified deviations and applied expert judgment as to whether the domestic regulations meet the Basel framework in letter and in spirit. The materiality analysis is summarised in Annex 4.

The Assessment Team noted that, in some areas, the assessed jurisdiction's rules go beyond the minimum Basel standards. Although these elements (listed in Annex 6) provide for a more rigorous implementation the Basel framework, they have not been taken into account for the assessment of compliance.

The outcome of the assessment is summarised using a four-grade scale, both at the level of each of the four key components of the Basel NSFR framework and the overall assessment of compliance. The four grades are: compliant (C), largely compliant (LC), materially non-compliant (MNC) and non-compliant (NC).

2 Assessment findings

2.1 Assessment grades and summary of findings

Overall, the Assessment Team finds the implementation of the NSFR in Japan to be compliant with the Basel NSFR standard. This grade is based on the materiality assessment (summarised in Annex 4).

Assessment grades

Table 1

Component of the Basel NSFR framework	Grade
Overall grade	C
Scope, minimum requirement and application issues	C
Available stable funding (numerator)	C
Required stable funding (denominator)	LC
NSFR disclosure requirements	C

Assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

2.1.1 Scope, minimum requirement and application issues

This component is assessed as compliant with the Basel NSFR standard. No findings were identified.

There is one observation that the implementation date in Japan is 30 September 2021, over three years after the Basel Committee's agreed implementation date of January 2018.

2.1.2 Available stable funding

This component is assessed as compliant with the Basel NSFR standard. No findings were identified.

There are two observations, both relating to the methodology for the calculation of available and required stable funding associated with derivative contracts.

2.1.3 Required stable funding

This component is assessed as largely compliant with the Basel NSFR standard.

The Assessment Team identified three non-material deviations under Japanese regulations with respect to (i) the RSF factor applied to unencumbered Level 1 securities; (ii) the RSF factor applied to unencumbered short-term (< six months) secured lending transactions backed by Level 1 assets; and (iii) the scope of variation margin received that may offset derivative assets. These deliberate deviations are meant to align Japanese rules with local NSFR implementation in some other jurisdictions. The same rules also introduced the above-mentioned deviations from the Basel NSFR standard. In aggregate, these deviations had a maximum total impact for any single bank of 3.1 percentage points and an average total impact of 1.65 percentage points for the banks included in the sample of this exercise. Against this background, the deviations were not deemed material on both aggregate and stand-alone level.

There are also four observations relating to (i) the scope of derivative contracts that are eligible for being treated on a net basis; (ii) the treatment of assets in relation to money trusts which are managed pursuant to the provisions of Articles 43-2 and 43-3 of the Financial Instruments and Exchange Act; (iii) the scope of allowed approaches to determine the eligibility of unencumbered loans for the application of the preferential 65% required stable funding factor; and (iv) the scope of transactions that may potentially be treated as interdependent (provided that the underlying conditions are met).

2.1.4 Disclosure requirements

This component is assessed as compliant with the Basel NSFR standard. No findings were identified.

There is one observation that the implementation date in Japan is 30 September 2021, over three years after the Basel Committee's agreed implementation date of January 2018.

2.2 Detailed assessment findings

2.2.1 Scope, minimum requirement and application issues

This component was judged to be compliant with the Basel NSFR standard. No findings were identified.

2.2.2 Available stable funding

This component was judged to be compliant with the Basel NSFR standard. No findings were identified.

2.2.3 Required stable funding

Section grade	Largely compliant
Basel paragraph number	Paragraph 35 of the Basel NSFR standard
Reference in the domestic regulation	Article 89(1) of the NSFR Pillar 1 Notice
Finding	Paragraph 35 of the Basel NSFR standard specifies the calculation of NSFR derivative assets. Specifically, collateral received in connection with derivative contracts may not offset the positive replacement cost amount, regardless of whether or not netting is permitted under the bank's operative accounting or risk-based framework, unless it is received in the form of cash variation margin and meets the conditions as specified in paragraph 25 of the Basel III leverage ratio framework and disclosure requirements. Under Japanese regulations, Article 89(1) of the NSFR Pillar 1 Notice provides for a larger scope of collateral received that may offset the positive replacement cost amount by also recognising as variation margin received Level 1 assets other than cash. Such assets include, for example, Japanese government bonds. Non-cash variation margin comprises at most 10% of variation margin received for the banks included in the sample. As such, the average impact of this deviation on the NSFR of the banks included in the sample is 0.03 percentage points. The maximum impact of the deviation for any single bank, compared with the Basel NSFR standard is 0.12 percentage points. Against this background, the deviation is deemed not material.
Materiality	Not material
Basel paragraph number	Paragraph 37 of the Basel NSFR standard
Reference in the domestic regulation	Articles 91(vii) and (ix) of the NSFR Pillar 1 Notice
Finding	Paragraph 37 of the Basel NSFR standard provides for the application of a required stable funding factor of 5% to unencumbered Level 1 assets (other than coins and banknotes and central bank reserves) as defined in paragraph 50 of the Basel LCR standards. Such assets include, for example, Japanese government bonds. As per paragraph 31 of the Basel NSFR standard on the treatment of encumbered assets, this RSF factor also applies to Level 1 assets that are encumbered for a period of less than six months. Under Japanese regulations, Article 91(vii) of the NSFR Pillar 1 Notice assigns a required stable funding factor of 0% to the above assets. The average impact of this deviation on the NSFR of the banks included in the sample is 0.97 percentage points. The maximum impact of the deviation for any single bank, compared with the Basel NSFR standard is 1.57 percentage points. Against this background, the deviation is deemed not material.
Materiality	Not material

Basel paragraph number	Paragraph 38 of the Basel NSFR standard
Reference in the domestic regulation	Article 91(viii) of the NSFR Pillar 1 Notice
Finding	Paragraph 38 of the Basel NSFR standard provides for the application of a required stable funding factor of 10% to loans to financial institutions with residual maturities of less than six months, where the loan is secured against Level 1 assets as defined in

	paragraph 50 of the Basel LCR standard, and where the bank has the ability to freely rehypothecate the received collateral for the life of the loan. Under Japanese regulations, Article 91(viii) of the NSFR Pillar 1 Notice assigns a required stable funding factor of 0% to related assets. The average impact of this deviation on the NSFR of the banks included in the sample is 0.67 percentage points. The maximum impact of the deviation for any single bank, compared with the Basel NSFR standard is 1.46 percentage points. Against this background, the deviation is deemed not material.
Materiality	Not material

2.2.4 Disclosure requirements

This component was judged to be compliant with the Basel NSFR standard. No findings were identified.

2.3 Observations on the NSFR implementation in Japan

The following observations highlight certain special features of the regulatory implementation of the Basel NSFR standard in Japan. These are presented to provide additional context and information. Observations are considered compliant with the Basel standards and do not have a bearing on the assessment outcome.

2.3.1 Scope, minimum requirement and application issues

Basel paragraph number	Paragraph 8 of the Basel NSFR standard
Reference in the domestic regulation	www.fsa.go.jp/news/r2/ginkou/20210331.html
Observation	Paragraph 8 of the Basel NSFR standard specifies that the NSFR was to become a minimum standard by 1 January 2018. However, in Japan, the NSFR only came into effect as a binding minimum requirement on 30 September 2021.

2.3.2 Available stable funding

Basel paragraph number	Paragraph 19 of the Basel NSFR standard
Reference in the domestic regulation	Articles 35(2) and 80 of the NSFR Pillar 1 Notice Article 8(2) of the Leverage Ratio Pillar 1 Notice
Observation	Paragraph 19 of the Basel NSFR standard specifies the conditions under which derivatives may be treated on a net basis for the purpose of the NSFR. Precisely, eligible bilateral netting contracts may only be considered where they meet the conditions as specified in paragraphs 8 and 9 of the annex of Basel III leverage ratio framework and disclosure requirements. Under Japanese regulations, Article 80 of the NSFR Pillar 1 notice implements paragraph 19 of the Basel NSFR standard by also making reference to legally valid bilateral netting contracts. A definition of such contracts is provided in Article 8(2) of the Leverage Ratio Pillar 1 Notice. However, the latter provision does not specify all the conditions of paragraphs 8 of the annex of the Basel III leverage ratio framework and disclosure requirements in the same granular manner. However, since the Japanese leverage framework has not yet been assessed, this finding is categorised as an observation rather than a deviation (this observation is identical to that noted in Section 2.3.3 for paragraph 34 of the Basel NSFR standard).
Basel paragraph number	Paragraph 20 of the Basel NSFR standard
Reference in the domestic regulation	Article 80 of the NSFR Pillar 1 Notice and Article 80-Q3 of Q&A document
Observation	Paragraph 20 of the Basel NSFR standard specifies that, in calculating NSFR derivative liabilities, collateral posted in the form of variation margin must be deducted from the negative replacement cost amount (see footnote 6 of the Basel NSFR standard). This is in the context of a calculation requiring banks to calculate required stable funding

	associated with current derivative exposures as the (positive) difference between NSFR derivative assets and NSFR derivative liabilities (multiplied with a required stable funding factor of 100%: see also paragraph 43(b) of the Basel NSFR standard). Under Japanese regulations, Article 80 of the NSFR Pillar 1 Notice (supplemented by Article 80-Q3 of the Q&A document) implements paragraph 20 of the Basel NSFR standard. However, Article 80 of the NSFR Pillar 1 Notice introduces a floor (of zero) to ensure that the amount of NSFR derivative liabilities after the deduction of collateral posted in the form of variation margin does not become negative. Article 80-Q3 of the Q&A document further specifies that any excess collateral posted in relation to derivative liabilities (ie the amount that is not offset against derivative liabilities because of the floor of zero) shall be treated as encumbered subject to a required stable funding factor depending on the period of encumbrance. Where the period of encumbrance is below one year, the required stable funding factor may be below 100% (depending on the type and residual maturity of the collateral posted). The Basel NSFR standard does not provide for such a floor and as such implies that the amount of NSFR derivative liabilities can become negative. The deduction of negative NSFR derivative liabilities from NSFR derivative assets mathematically results in an increase in the amount of net NSFR derivative assets to which a required stable funding factor of 100% will be applied, ie excess collateral in the form of variation margin posted is subject to an implicit required stable funding factor of 100% under the Basel NSFR standard. This treatment is specified in a formula included in a footnote within the Basel NSFR standard and not in the text of the standard itself. The impact of the derivatives floor is to be assessed in the context of Japanese regulations specifying that this floor should be applied at transaction/netting set level while NSFR derivative liabilities should be calculated at the aggregate level under the Basel NSFR standard ("portfolio-based offsetting"). While this additional specification does not constitute a deviation from the Basel NSFR standard, its combination with the application of the derivatives floor may increase the amount of excess collateral that could be subject to a required stable funding factor of less than 100% (as opposed to the implicit required stable funding factor of 100% assumed under the Basel NSFR standard). The observation relating to the application of a derivatives floor, excess collateral and netting at the transaction/netting set level is also relevant for the calculation of NSFR derivative assets. However, with regard to the calculation of NSFR derivative assets, the introduction of a floor (of zero) ensuring that the amount of NSFR derivative assets does not become negative is actually more conservative than the Basel NSFR standard (see also Annex 6). In the light of the observation above, the Basel Committee is requested to provide further guidance on the treatment of excess collateral posted as variation margin in relation to derivative liabilities (see Annex 5).

2.3.3 Required stable funding

Basel paragraph number	Paragraph 34 of the Basel NSFR standard
Reference in the domestic regulation	Article 89 of the NSFR Pillar 1 Notice Article 8(2) of the Leverage Ratio Pillar 1 Notice
Observation	See observation in Section 2.3.2 regarding paragraph 19 of the Basel NSFR standard.
Basel paragraph number	Paragraph 36 of the Basel NSFR standard
Reference in the domestic regulation	Article 91(v) of the NSFR Pillar 1 Notice

Observation	Paragraph 36 of the Basel NSFR standard lists the assets which should be subject to a required stable funding factor of 0% (eg coins and banknotes, central bank reserves, claims on central banks with residual maturities of less than six months, trade date receivables arising from sales of financial instruments, foreign currencies and commodities that (i) are expected to settle within the standard settlement cycle or period that is customary for the relevant exchange or type of transaction; or (ii) have failed to, but are still expected to, settle). Under Japanese regulations, applicable regulations additionally apply a required stable funding factor of 0% to assets in relation to money trusts which are managed pursuant to the provisions of Articles 43-2 and 43-3 of the Financial Instruments and Exchange Act. On substance, these structures refer to cases where banks are acting as trustees and are investing investors' money in securities (and these assets are then managed separately from the other assets owned by the banks). The trustees do not guarantee repayment of the principal and the investors do not have a claim against the banks but rather a beneficial interest in the trust property. Assets in relation to money trusts are not explicitly referred to in paragraph 36 of the Basel NSFR standard. However, they may meet the criteria under paragraph 45 of the Basel NSFR standard, which provides for the possibility to apply available and required stable funding factors of 0% to assets with interdependent liabilities. On this basis, applying a required stable funding factor of 0% to assets related to money trusts may not constitute a deviation from the Basel NSFR standard but may rather constitute an example where the Japanese authorities could make use of the national discretion provided in paragraph 45 of the Basel NSFR standard.
Basel paragraph number	Paragraph 41 of the Basel NSFR standard (and FAQ 28 of the Basel NSFR standard)
Reference in the domestic regulation	Article 95 of the NSFR Pillar 1 Notice and Article 95-Q1 of the Q&A document
Observation	Paragraph 41 of the Basel NSFR standard lists the assets subject to a required stable funding factor of 65%. To determine which assets receive this factor, the Basel NSFR standard refers to the risk weights that are applied to assets under the Basel II standardised approach to credit risk. Only assets that are subject to a 35% or lower risk weight under the Basel II standardised approach for credit risk can receive a 65% RSF factor. Assets that are subject to a risk weight higher than 35%, are subject to a higher required stable funding factor of 85% or 100%, (depending on whether these assets fall within scope of paragraph 42 or 43, of the Basel NSFR standard.) This approach is supported by FAQ 28 of the Basel NSFR standard, which further specifies that, in the context of determining the eligibility of assets for the purpose of the treatment referred to in paragraph 41 of the Basel NSFR standard, only the Basel II standardised approach for credit risk may be used to determine the NSFR treatment. That is, even where a bank is accredited to use the IRB approach to credit risk, the risk weights derived under that approach may not be used to determine which assets should receive the RSF factors specified under paragraph 41. Under Japanese regulations, Article 95 of the NSFR Pillar 1 Notice implements paragraph 41 of the Basel NSFR standard. However, Article 95-Q1 of the Q&A document provides some allowance for banks to use approaches other than the Basel II standardised approach for credit risk when calculating the risk weights that determine whether an asset may receive a required stable funding factor of 65%. However, such an approach may be used only if it is sufficiently conservative and found to be more stringent in its application than the Basel standards. Given that, as per the RCAP handbook, FAQs cannot be cited as the sole source of a deviation, but rather can only be assessed in conjunction with the relevant Basel text that it clarifies and taking into consideration the conservativism that must be applied under any alternative approach, this finding is categorised as an observation rather than a deviation.
Basel paragraph number	Paragraph 45 of the Basel NSFR standard (and FAQ 9 of the Basel NSFR standard)
Reference in the domestic regulation	Article 101 of the NSFR Pillar 1 Notice and Article 101-Q1 of the Q&A document
Observation	Paragraph 45 of the Basel NSFR standard gives national supervisors the discretion to determine whether certain asset and liability items, on the basis of contractual

	arrangements, are interdependent such that the liability cannot fall due while the asset remains on the balance sheet, the principal payment flows from the asset cannot be used for something other than repaying the liability, and the liability cannot be used to fund other assets. Further conditions are included under this paragraph. While this paragraph does not exclude, ex ante, any items from potentially being in the scope of interdependent assets and liabilities, further criteria to be considered by supervisors are set out in paragraph 45 of the Basel NSFR standard. In addition, NSFR FAQ 9 of the Basel NSFR standard further specifies that this treatment is not intended to be applied to derivative transactions, since it would rarely be the case that derivatives would meet all conditions. Under Japanese regulations, Article 101 of the NSFR Pillar 1 Notice implements paragraph 45 of the Basel NSFR standard. Specifically, the qualitative criteria referred to in the Basel NSFR standard are explicitly mentioned in the Japanese regulations. However, Article 101-Q1 of the Q&A document includes Japanese banks' derivative transactions related to client clearing activities as being in the scope of assets and liabilities that can be treated as interdependent to the extent that banks can demonstrate compliance with the above requirements. The possibility to include derivative transactions related to client clearing activities in the scope of interdependent assets and liabilities may be interpreted as going beyond the flexibility embedded in NSFR FAQ 9 of the Basel NSFR standard. However, such an inclusion is presented as an observation since, consistent with the RCAP methodology (see the RCAP Handbook), an FAQ cannot be cited as the sole source of a deviation, but rather is assessed in conjunction with the relevant Basel text that it clarifies (the latter not limiting ex ante the scope of interdependent assets and liabilities). In the light of the observation above, the Basel Committee is requested to provide further guidance on the eligibility of derivative transactions associated with client clearing activities as interdependent assets and liabilities (see Annex 5).

2.3.4 Disclosure requirements

Basel paragraph number	Paragraph 8 of the Basel NSFR disclosure standard
Reference in the domestic regulation	www.fsa.go.jp/news/r2/ginkou/20210331.html
Observation	Paragraph 8 of the Basel NSFR disclosure standard stipulates that the NSFR disclosure requirements were to come into effect no later than 1 January 2018. However, in Japan, the NSFR disclosure requirements only came into effect as a binding minimum requirement on 30 September 2021.

Annexes

Annex 1: RCAP Assessment Team and Review Team

Assessment Team Leader

Mr Daniel Perez	Bank of Spain
Mr Giuseppe Siani	ECB Banking Supervision (until March 2020)

Assessment Team members

Dr Martin Sprenger	Hong Kong Monetary Authority
Mr Maximilian Dinse	ECB Banking Supervision
Mr Hamit Serkan Aksu	Bankacılık Düzenleme ve Denetleme Kurumu (BDDK) Turkey
Mr Andrew Linn	Bank of England Prudential Regulation Authority
Mr Stuart Dossett	Bank of England (until March 2020)

Supporting members

Ms Rebeca Anguren	Bank of Spain
Mr Claudio Castro	ECB Banking Supervision (until March 2020)
Ms Irina Barakova	Basel Committee Secretariat
Mr Puneet Pancholy	Basel Committee Secretariat (until 31 October 2021)
Mr Olivier Prato	Basel Committee Secretariat

Review Team members

Mr Yasser S Alghofily	Saudi Central Bank
Mr Chris Gower	Australian Prudential Regulatory Authority
Mr Stefan Hohl	Basel Committee Secretariat
Mr Tony	Indonesian Financial Services Authority

Annex 2: List of Basel standards and implementing regulations issued by Japanese authorities

The following Basel standards were used as the basis of this RCAP assessment:

- *Basel III: the Net Stable Funding Ratio*, October 2014
- *Pillar 3 disclosure requirements – consolidated and enhanced framework*, March 2017
- *Implementation of Net Stable Funding Ratio and treatment of derivative liabilities*, October 2017

Table A.1 lists the regulations issued by the JFSA to implement the NSFR in Japan. Previous RCAP assessments of Japanese implementation of the Basel standards considered the binding nature of regulatory documents in Japan.[5] This RCAP Assessment Team did not repeat that assessment, but instead relied on the findings of previous assessments. Those assessments concluded that the types of instrument described in Table A.1 could be considered as binding on banks and supervisors for the purposes of an RCAP assessment.

Overview of relevant Japanese liquidity regulations — Table A.1

Domestic regulations	Type, version and date
Banking Act (Act No. 59 of 1 June 1981)	Law issued in June 1981 and revised subsequently (most recently in June 2021)
Order for Enforcement of the Banking Act (Cabinet Order No. 40 of 27 March 1982)	Law issued in March 1982 and revised subsequently (most recently in November 2021)
Regulation for Enforcement of the Banking Act (Ministry of Finance Order No. 10 of 31 March 1982)	Law issued in March 1982 and revised subsequently (most recently in April 2022)
Criteria for determining soundness in terms of liquidity to be established by Banks as criteria for determining the soundness of their management pursuant to the provision of Article 14-2 of the Banking Act (Financial Services Agency Notice No. 60 of 2014)	Pillar 1 Notice issued in October 2014, revised in March 2021
Matters Specified Separately by the Commissioner of the Financial Services Agency concerning the Condition of Soundness of Management in Terms of Liquidity Pursuant to the Provisions of Article 19-2, Paragraph (1), Item (v), (e), etc. of the Regulation for Enforcement of the Banking Act (Financial Services Agency Notice No. 7 of 2015)	Pillar 3 Notice issued in February 2015, revised in March 2021
Q&A of Notices	Regulation issued in December 2014, revised in March 2021
Supervisory Guidelines	Regulation issued in October 2005 and revised subsequently (most recently in June 2021)

Source: JFSA.

[5] Please see Annex 5, Assessment of the bindingness of regulatory documents, www.bis.org/bcbs/publ/d391.pdf.

Annex 3: Key liquidity indicators of the Japanese banking system

Overview of Japanese banking sector liquidity as of 30 September 2021 — Table A.2

Size of banking sector (JPY, millions)		
Total exposures of all banks operating in Japan (including off-balance sheet exposures)	2,009,623,646	
Total assets of all locally incorporated internationally active banks	1,276,596,363	
Total assets of locally incorporated banks to which liquidity standards under the Basel framework are applied	1,276,596,363	
Number of banks		
Number of banks operating in Japan (excluding local representative offices)	112	
Number of global systemically important banks (G-SIBs)	3	
Number of D-SIBs	4	
Number of banks which are internationally active	19	
Number of banks required to implement Basel III liquidity standards	19	
Number of banks required to implement domestic liquidity standards	19	
Breakdown of NSFR for Japan RCAP sample banks (JPY, millions)	**Unweighted**	**Weighted***
Capital	61,821,717	61,821,717
Stable deposits from retail and small business customers	57,254,303	54,393,429
Less stable deposits from retail and small business customers	171,925,853	155,386,348
Unsecured funding from non-financial corporates	213,163,110	108,107,211
Unsecured funding from central banks, sovereigns, PSEs, MDBs and NDBs	37,781,549	14,929,361
Unsecured funding from financials (other legal entities)	214,270,192	70,315,302
Secured funding (all counterparties)	146,607,193	38,239,202
Other liabilities	53,742,414	1,428,001
Total available stable funding	956,566,331	504,620,571
Cash and central bank reserves	259,071,227	0
Loans to financial institutions	101,242,672	44,559,472
Securities eligible as Level 1 HQLA	150,698,864	21,587,882
Securities eligible as Level 2A HQLA	12,847,378	2,299,909
Securities eligible as Level 2B HQLA	17,718,213	9,785,582
All residential mortgages	27,680,361	19,641,745
Loans, <1 year	84,633,579	41,632,930
Other loans, >1 year, risk weight<=35%	7,014,319	4,672,175
Loans, risk weight>35%	165,092,064	140,176,436
Derivatives	4,413,094	4,793,597
All other assets	126,031,601	110,840,845
Off-balance sheet	339,636,173	5,927,905
Total required stable funding	1,296,079,545	403,391,394
NSFR		125.4%

Source: JFSA.
*The weights applied in this column refer to the applicable stable funding factors.

RCAP sample banks

Table A.3

Banking group	Share of banks' assets in the total assets of the JFSA banking system (September 2021)
Mitsubishi UFJ Financial Group	19.0%
Sumitomo Mitsui Financial Group	12.9%
Mizuho Financial Group	12.0%
Sumitomo Mitsui Trust Holdings	3.3%
Norinchukin Bank	5.5%
Total	52.6%

Source: JFSA. For this purpose, banking assets are based on the measure of total exposures used in the leverage ratio, which includes both on- and off-balance sheet exposures.

Annex 4: Materiality assessment

The outcome of the RCAP assessment is based on the materiality of the findings described in Section 2.2 and summarised in Table A.3. Assessment Teams evaluate the materiality of findings quantitatively where possible, or using expert judgment when the impact cannot be quantified.

The materiality assessment for quantifiable gaps is based on the cumulative impact of the identified deviations on the reported NSFRs of banks in the RCAP sample. These banks are listed in Table A.4.

Number of deviations by component

Table A.4

Component	Not material	Potentially material	Material
Scope, minimum requirement and application issues	0	0	0
Available stable funding (numerator)	0	0	0
Required stable funding (denominator)	3	0	0
NSFR disclosure requirements	0	0	0

In aggregate, the required stable funding deviations, as listed above, had a maximum total impact on any one bank of 3.1 percentage points, and an average total impact of 1.65 percentage points. Against this background, the deviations were not deemed material. The assessment team did not identify any pending changes to the Japanese regulatory framework or trends that point to a potential change in the materiality of these deviations in the near future.

Annex 5: Areas for further guidance from the Basel Committee

The Assessment Team listed the following issues for further guidance from the Basel Committee.

Treatment of excess collateral posted as variation margin in relation to derivative liabilities (paragraphs 20 and 43(b) of the Basel NSFR standard)

The Assessment Team believes it would be helpful to receive guidance from the Basel Committee on the appropriateness of the implicit assumption of a required stable funding factor of 100% applied to excess collateral posted as variation margin in relation to derivative liabilities.

This implicit assumption stems from the absence of a floor in relation to the formula specifying the calculation of NSFR derivative liabilities, allowing this amount to become negative. The deduction of negative NSFR derivative liabilities from the amount of NSFR derivative assets would mathematically result in an increase in the amount of net NSFR derivative assets to which a required stable funding factor of 100% will be applied (see paragraphs 20 and 43(b) of the Basel NSFR standard).

In this context, the Basel Committee could examine to what extent it is appropriate to treat excess collateral posted in relation to derivative liabilities in the same manner as collateral posted that offsets derivative liabilities (ie in both cases, a required stable funding factor of 100% is assumed).

Eligibility of derivative transactions associated with client clearing activities as interdependent assets and liabilities (paragraph 45 and FAQ 9 of the Basel NSFR standard)

The Assessment Team believes it would be helpful to get confirmation from the Basel Committee on whether all derivative transactions, including those associated with client clearing, are excluded ex-ante from the scope of paragraph 45 of the Basel NSFR standard (as per FAQ 9 of the Basel NSFR standard).

In the context of the RCAP assessment, the Assessment Team worked under the assumption that FAQ 9 of the Basel NSFR standard may exclude all derivative transactions from being in the scope of paragraph 45 of the Basel NSFR standard, including those associated with client clearing activities.[6] This is because FAQ 9 of the Basel NSFR standard specifies that paragraph 45 of the Basel NSFR standard is not intended to be applied to derivative transactions, thus implying a general exclusion.

In this context, the Basel Committee could examine to what extent this general exclusion is appropriate in all circumstances, and whether some flexibility could be justified. Specifically, in the context of derivative client clearing activities, there could be scenarios where the qualitative criteria under paragraph 45 of the Basel NSFR standard are met and where banks do not incur any funding risk, thus potentially justifying the consideration of derivative transactions related to such client clearing activities under paragraph 45 of the Basel NSFR standard.

6 **Basel NSFR FAQ 9**: *Do derivative transactions qualify for the treatment of interdependent assets and liabilities referred to in paragraph 45 of the NSFR standard?* → No, according to paragraph 45 of the NSFR standard, national supervisors have discretion in limited circumstances to determine whether certain asset and liability items, on the basis of contractual arrangements, are interdependent. […]. This treatment, therefore, is not intended to be applied to derivative transactions, since it is rarely the case that derivatives would meet all conditions. Furthermore, the fulfilment of the conditions provided for by paragraph 45 would not automatically lead to the application of the treatment of interdependent assets, as supervisors are still required to consider whether perverse incentives or unintended consequences are being created by approving this treatment for certain operations, before exercising such discretion.

Annex 6: Areas where the Japanese rules are stricter than the Basel standards

In one area, the Japanese authorities have adopted a stricter approach than the minimum standards prescribed by the Basel Committee. This item is listed below for information. The stricter rule has not been taken into account as mitigants for the overall or component-level assessment of compliance.

Treatment of excess cash collateral received as variation margin in relation to derivative assets (paragraphs 35 and 43(b) of the Basel NSFR standard)

Paragraph 35 of the Basel NSFR standard specifies that, when calculating NSFR derivative assets, cash variation margin meeting the conditions under paragraph 25 of the Basel III leverage ratio framework and disclosure requirements may be deducted from the replacement cost of gross derivative assets. To recall, the required stable funding associated with current derivative exposures is then calculated as the difference between NSFR derivative assets and NSFR derivative liabilities (multiplied with a required stable funding factor of 100%: see also paragraph 43(b) of the Basel NSFR standard).

Under Japanese regulations, Article 89 of the NSFR Pillar 1 Notice implements paragraph 35 of the Basel NSFR standard. However, Article 89 of the NSFR Pillar 1 Notice introduces a floor (of zero) at transaction/netting set level to ensure that the amount of NSFR derivative assets after the deduction of cash variation margin received at transaction/netting set level does not become negative.

A literal reading of the Basel NSFR standard suggests that the Japanese regulation deviates from the Basel NSFR standard as the latter does not provide for a floor. In that regard, the Japanese regulation is stricter than the Basel NSFR standard, where excess cash variation margin received may effectively offset uncollateralised derivative assets in other transactions/netting sets ("portfolio-based offsetting").

Annex 7: Elements of the NSFR subject to national discretion

Implementation of national discretions by the Japanese authority — Table A.5

Basel paragraph	Description	National implementation
25(a)	Treatment of deposits between banks within the same cooperative network	Under the Japanese law, deposits between banks within the same cooperative network are required to be placed at the central organisation and are legally constrained within the cooperative bank network as minimum deposit requirements. Norinchukin Bank is a central organisation of agricultural cooperatives, and its ASF includes the deposits from these agricultural cooperatives.
31	Treatment of excess collateral in a covered bond collateral pool allowing for multiple issuance	NA
31, 36	Treatment of central bank operations	Assets that are encumbered for the exceptional central bank operations (ie operations conducted ad hoc by central banks etc in the case where the entire market is under stress or there are exceptional macroeconomic issues) shall receive a reduced RSF factor. For the purposes of calculating the NSFR, such assets shall receive the same RSF factor as an equivalent asst that is unencumbered.
43	RSF factor for derivative liabilities	The FSA sets 5% of all derivative liabilities (ie negative replacement cost amounts before deducting variation margin posted) ,which receive a 100% RSF factor, in accordance with "NSF30.32, Available and required stable funding, Version effective as of 15 Dec 2019, First version in the format of the consolidated framework".
45	Treatment of interdependent assets and liabilities	The FSA sets the treatment of interdependent assets and liabilities in accordance with the Basel paragraph 45.
47	RSF factors for other contingent funding obligations	The FSA sets the RSF factors based on national circumstances.
50	Scope of application of NSFR and scope of consolidation of entities within a banking group	The NSFR requirements are applicable to internationally active banks in Japan on both a consolidated and non-consolidated basis.

Source: JFSA.