April 16, 2010

Basel Committee on Banking Supervision

The Norinchukin Bank

Comments on the Basel Committee Consultative Documents, *Strengthening the resilience of the Banking Sector* and *International Framework for Liquidity Risk Measurement, Standards and Monitoring*

The Norinchukin Bank ("the Bank") is the central bank for the agricultural, forestry and fishery cooperatives in Japan. The mission of the Bank is to contribute to the development of these industries and to national economic prosperity by providing financial services for the member cooperatives under its umbrella. The Bank functions as a national level central bank mainly for 740 agricultural cooperatives ("JA") and 1,088 fishery cooperatives ("JF") which are located in cities, towns and villages nationwide with approximately 11 million members (as of April 1 2009, the same applies hereinafter) serving in the agriculture, fisheries and forestry industries, as well as for 38 prefectural banking federations ("Shinnoren") of JA and 30 prefectural banking federations ("Shingyoren") of JF, all of which are the Bank's shareholders ("member banks") and depositors.

The total amount of deposits placed at both the JA and JF stand at approximately 85 trillion yen (out of which 74 trillion yen is in retail deposits), which accounts for nearly 10% of the retail deposits in Japan. Residual funds that are deposited with the Bank through Shinnoren and Shingyoren after loans have been made to their cooperative members by JA and JF amount to approximately 36 trillion yen. .

In the three-tier JA Bank Group System that consists of JA, Shinnoren and the Bank, the requirements for minimum deposits from member cooperatives to their umbrella organization have been set within the Group's Basic Policy under the provisions of the law for JA Bank Group System, which is known as the "Act on Enhancement and Restructuring of the Credit Business Conducted by The Norinchukin Bank and Specified Agricultural and Fishery Cooperative Savings Insurance Cooperation". Almost all member cooperatives have instituted the minimum deposit requirements into their Articles of Incorporation. Furthermore, as deterrence to non-compliance, the System can take an action to expel any member cooperative that can not keep the requirements constantly. Supported by those well-disciplined regimes, the Bank's financial ties with the member cooperatives are extremely strong.

The Bank provides its member cooperatives with appropriate functionality by providing financial intermediation to meet needs not only of its member cooperatives but also of its individual members and end users (farmers, etc.). The Bank also returns profits to its member cooperatives by managing their funds in a centralized and efficient manner.

A number of cooperative financial institutions similar to our group exist not only in Japan but also around the world, including in the major G20 nations. They assume major roles mainly in the retail banking sector. The Norinchukin Bank is an associate member of the European Association of Co-operative Banks ("EACB").

The Bank highly respects the Committee's efforts and appreciates the opportunity to comment on the consultative documents ("these documents") issued by the Basel Committee on Banking Supervision ("the Committee").

The Bank, as a member of the Japanese Bankers Association ("JBA"), has already issued a comment through the JBA on topics and issues that are of common interest among Japanese banks.

In the following paragraphs, the Bank submits comments that it would like to emphasize among the JBA comments and additional comments that are specific to the Bank as being the central cooperative bank, which is unique in terms of business model and organizational characteristics.

I Executive Summary

1 General Topics

(1) General Considerations

- Prior to the finalization of the reform proposals, due consideration should be given to the extent of the impact the reforms will have on the financial system and eventually on the real economy. At the same time, deeper studies should be undertaken in order to find the right balance between the stability of the financial system to be achieved through the introduction of the reforms on the one hand and market functioning to be constrained and economic cost to be increased by the reforms on the other hand.

- The combined and cumulative impacts of numerous reforms that are currently under consideration need to be examined so that the reform proposals will be adjusted appropriately. It is also necessary that consistency be achieved among various regulatory proposals.

(2) Measures to mitigate unwanted impacts that radical changes may have on the real economy

- The reforms may require international harmonization in the medium term, but their implementation modalities and timelines need to take into account each country's circumstances to a certain extent based on the fact that economic and financial circumstances as well as fundamental systems for accounting and taxation vary from country to country.

  Phase-in and sufficient grandfathering provisions are essential for the implementation of the new regime.

(3) Considerations for the specific constitution and business models of the cooperative financial institutions

- Standards that are tailored to joint-stock financial institutions should not be mechanically applied to the cooperative financial institutions. The Bank strongly requests that the specific organizational characteristics and business models of the cooperative financial institutions be fully taken into account so that the standards will be substantively fair to all forms of banking institutions.

2 Specific Topics

(1) Quality of Capital

a Criteria governing inclusion in the Common Equity component of Tier 1

- The Bank strongly supports the intent of Footnote No.19 of these consultative documents, which clearly state, "taking into account their specific constitution and legal structure", and specify that the standards for capital requirements that are tailored to joint stock financial institutions will not be mechanically applied to the cooperative financial institutions.

b Investments in the capital of certain banking, financial and insurance entities that are outside the regulatory scope of consolidation (Capital deduction of exposures to financial institutions in the holdings of index securities)

- The implementation of proposed deduction requirements for index securities will work to constrain flexible risk management of banks, as changes are constantly made to the allocation of index securities holdings so that the risk of the entire portfolio is controlled appropriately. In addition, the proposed requirements to look through holdings of index

securities and to deduct holdings of common stock in financial institutions are excessive and disproportionately costly relative to the intended results of the requirements. Given all this, it will be appropriate not to deduct holdings of common stock in financial institutions from index securities portfolios.

(2) Risk Coverage

a A multiplier for the asset value correlation for large financial institutions

- The application of a higher asset value correlation (AVC) multiplier will have a significant impact not just on both the investment and funding activities but ultimately on the financial intermediary activities of financial institutions. The impact should be sufficiently examined. Furthermore, the requirements need to take into account the differences in types of transactions. A possible application of lower multipliers, for instance, needs to be considered for money market transactions between banks.

(3) Leverage Ratio

a Positioning of the leverage requirements

- The leverage ratio requirements, even if they are to be introduced, should not be included in the Pillar1 requirements, on the grounds that the requirements may generate such side-effects as a possible deterioration in the quality of assets held by financial institutions. Moreover, accounting systems and tax systems vary significantly from country to country, and this poses difficulties for achieving truly fair standards for financial institutions on a global level.

b Treatment of high quality liquid assets

- The exclusion of high quality liquid asset holdings from the leverage ratio is appropriate so as to ensure consistency with the liquidity requirements that encourage increased holding of high quality liquid assets.

(4) Procyclicality Control

a Treatment of profit distribution constraints on the central cooperative banks

- Retail banking services in the cooperative banking system are assumed

mainly by its member banks. For such reason, a mechanical application of the restrictions on the distribution of profits to the member cooperatives by the central cooperative banks will disrupt retail financing capabilities of the member cooperatives. The real economy may be adversely impacted and the procyclicality may rather be enhanced as a result. It is at least inappropriate to require a mechanical application of restrictions on distribution of profits from the central cooperative banks to their membership cooperatives, or to enforce the one-size-fits-all table as illustrated in the documents.

(5) Liquidity Requirements

a Positioning of the liquidity requirements

- Liquidity risk profile is rather unique to each financial institution. Therefore, the liquidity management approach that employs a one-size-fits-all set of metrics does not work for this particular category without causing significant distortions. Therefore, the liquidity requirements should be positioned as Pillar2 requirements.

- Liquidity risk-related standards are going to be introduced on a global level for the first time. Therefore, a trial period of at least a year should be established prior to their official introduction so that all of the parties concerned will be able to improve their understanding on trends, assessments and other metrics relating to the liquidity information.

b The treatment of deposits placed at the central cooperative banks from cooperative membership banks on the calculation of LCR and NSFR

- The Bank strongly requests inclusion of a clear statement in the standards, providing that the calculation of liquidity ratios with respect to deposits at the central cooperative banks from their membership cooperatives will be based upon the original deposit attribution at the membership cooperative level.

c Disclosure of Liquidity-related information

- Liquidity-related information may incur reputational risk. Therefore, its information should not be disclosed until markets acquire the ability of accurate interpretation of liquidity risk-related data.

Ⅱ Comments

1 General Topics

Topics and Discussion points	Consultative Document Title Paragraph No.	Comment
(1) General Topics	**"Strengthening the resilience of the banking sector" 1～17 60～64**	・ The Norinchukin Bank generally supports the principles of the Committee's initiatives, as a result of the recent financial crisis, to promote a more resilient financial system as well as to close the regulatory gaps among nations by strengthening both capital and liquidity requirement frameworks so that the risk of the real economy being adversely impacted by the financial turmoil in the banking sector is mitigated ・ Prior to the finalization of the reform proposals, due consideration should be given to the extent of the impact the reforms will have on the financial system and eventually on the real economy. At the same time, careful economic and financial studies at both the micro and macro levels should be undertaken in order to find the right balance between the stability of the financial system to be achieved through the introduction of the reforms on the one hand, and market functioning to be constrained and economic cost to be increased by the reforms on the other hand. ・ Considerable attention must also be paid to address the combined and cumulative effects brought about by the reforms of regulatory, accounting and other rules and standards that are being discussed concurrently. It is also important to ensure that consistency and harmonization are achieved across

		such rules and standards. ・ It is extremely important that these regulatory reforms are implemented consistently across all countries and financial institutions, and on a level playing field based on the fact that legal and accounting systems differ among nations and likewise organizational characteristics differ among financial institutions. The reforms need to provide true level-playing foundations for the global financial system to achieve sounder development.
(2) Measures to mitigate unwanted impacts that radical changes may have on the real economy	**"Strengthening the resilience of the banking sector" 1〜17 60〜64**	・ The reforms may require international harmonization in the medium term, but their implementation modalities and timelines need to take into account each country's circumstances to a certain extent based on the fact that economic and financial circumstances as well as the fundamental systems for accounting and taxation vary from country to country. ・ Phase-in and sufficient grandfathering provisions are essential for the implementation of the new regime, taking into account the still unstable global economy and the real economic conditions of each nation. ・ At least for the moment, real economies and financial systems vary among G20 member nations. For instance, too hasty adoption of drastically changed standards to the financial institutions in Japan which are currently experiencing genuine deflation would cause a massive negative impact on the nation's real economy, and this is a cause for a

		major concern.
(3) Thoughts regarding specific constitution and Business models of cooperative financial institutions	**"Strengthening the resilience of the banking sector" 1〜17 60〜64**	• Standards that are tailored to joint-stock financial institutions should not be mechanically applied to the cooperative financial institutions simply for the sake of achieving superficial harmonization. The Bank strongly requests that the organizational characteristics and business models of each financial institution be fully taken into account so that the standards will be substantively fair to all forms of banks. • The cooperative financial institutions assume important role in the financial system mainly in the retail banking sector of a number of G20 member nations. The Bank urges full understanding of and respect to the fact that the cooperative financial institutions, over a long history since the 19th century, have come to form their distinctive capital structures and systems of collecting funds by means of deposits within the group in a hierarchical manner so as to provide appropriate financial intermediation to meet needs not only of its member banks but also of their individual members and end users (farmers, etc.) as well as to manage their funds efficiently.

2 Specific Topics

Topics and Discussion points	Consultative Document Title Paragraph No.	Comment
(1) Quality of Capital		
a Criteria governing inclusion in the Common equity component of Tier 1	**"Strengthening the resilience of the banking sector" 87**	• The Bank strongly supports the intent of Footnote No.19 of the consultative documents, which clearly state, "taking into account their specific constitution and legal structure", and specify that standards for capital requirements that are tailored to joint stock financial institutions will not be mechanically applied to the cooperative financial institutions. • Any portion of the capital of the cooperative financial institutions which is deemed virtually equivalent to that of joint stock financial institutions in terms of loss absorption capacity and in view of its quality and reality, should naturally be treated equally under the same criteria
b Investments in the capital of certain banking , financial and insurance entities which are outside the regulatory scope of consolidation **(Capital deduction of exposures to financial institutions in the holdings of index securities)**	**Same as above 101**	• Given the fact that index securities holdings are managed to control the market risk of the entire portfolio, rather than to take the risk of specific financial institutions, the allocation of index securities holdings in the entire portfolio changes constantly. Under such circumstances, the requirements will work to constrain flexible risk management of banks. • Moreover, the proposed requirements to look through holdings of index securities to deduct holdings of common stock in financial institutions are excessive and disproportionately costly relative to the intended results of the

		requirements. ・ The holdings of index securities that include common stocks in financial institutions have already been charged against capital in the numerator using the internal models market-based approach for equity exposure. Therefore, the proposed deduction requirement represents a double counting of the capital burden. This double counting could, in theory, be avoided if re-collection of the past daily for sufficiently long period data excluding relevant financial institutions for recalibration were available. However, in reality, such re-collection of such detailed and accurate data is not feasible. ・ In view of all of the reasons above, it will be appropriate not to deduct holdings of common stock in financial institutions within index securities portfolios from capital.
(2) Risk Coverage		
a A multiplier for the asset value correlation for large financial institutions	**Same as above 135～140**	・ The application of a higher asset value correlation (AVC) multiplier will have a significant impact not just on both investment and funding activities but ultimately on the financial intermediary activities of financial institutions. Such impact should be sufficiently examined. Furthermore, the requirements, rather than being applied solely on the basis of financial institutions' assets size and business type, need to take into account the differences in the types of transactions that are carried out. ・ For daily money market transactions between banks that arise along with the provision of credit to the real economy, a

		possible application of lower multipliers may need to be considered separately from the derivatives transactions that are almost exclusively in the exposures among financial institutions. • It is not possible at this point to present concrete calibration proposals for of higher AVC multipliers to major financial institutions, as the proven analysis of the concrete definition or the correlations of major financial institutions is not available. • Resilience to the spillover effects among financial institutions in the period of stress will be strengthened by the increased requirements for liquidity risk management that reflect lessons from the recent financial crisis. However, capital charges may well be excessive if the multiplier is calibrated on the basis of correlations that existed prior to the introduction of new standards (e.g. the liquidity standards)
(3) Leverage Ratio		
a Positioning of the leverage requirements	**Same as above 24～27 202～206**	• The application of various metrics is deemed effective in verifying soundness of financial institutions. The leverage ratio requirements, however, should not be included in the Pillar1 requirements even if they are to be adopted. • The leverage ratio requirements, as addressed in the Working Paper[1] issued by the Bank of Japan in March 2010, may curtail leverage, but are likely to generate various side effects at the same time. For

[1] "How Can Leverage Regulations Work for the Stabilization of Financial Systems? "

		instance, the requirements may deteriorate the quality of assets held by financial institutions and damage the soundness of their management. In other words, financial institutions may try to shift their asset portfolios from safe assets to riskier assets in their attempt to maximize expected utility. One example of such side-effects can be found in Japan's experience of the accumulation of non-performing assets under the leverage regime during the years of the asset-inflated economic bubbles in the mid-1980s. ・ Furthermore, the accounting systems and tax systems vary significantly from country to country, which hamper the process toward achieving truly level playing field for financial institutions on a global level.
b Treatment of high quality liquid assets	**Same as above 219**	・ The Committee, in these documents, has expressed its intention to assess the interaction of the leverage ratio and liquidity requirements. Even if the leverage ratio requirements are to be introduced, it is necessary to exclude high quality liquid assets from the leverage ratio so as to ensure consistency with the liquidity requirements that encourage increased holding of high quality liquid assets.
(4) Procyclicality Control		
a Treatment of profit distribution constraints on the central cooperative banks	**Same as above 38～40 254～259**	・ It is inappropriate to require a mechanical application of restrictions on distribution of profits from the central cooperative banks to their membership cooperatives, or to enforce a one-size-fits-all table as illustrated in these documents. ・ As integral part of the

		macro-prudence policies, a comprehensive and exhaustive impact analysis should be conducted prior to the introduction of procyclicality control measures along with the analysis on the requirements for risk-based capital adequacy ratios and various cross-boarder rules and standards including accounting standards. ・ Furthermore, retail banking services in the cooperative banking system are assumed mainly by its member cooperatives (unit coops). Therefore, a mechanical application of the restrictions on the distribution of profits to the member cooperatives by the central cooperative banks will not only disturb the process of improving the soundness of the cooperative financial group as whole, but may also destabilize business standings and disrupt retail financing capabilities of their member banks. The possibility even exists that the real economy may be adversely impacted and the procyclicality may rather be accelerated as a result. ・ Withdrawal of capital buffers for profit distributions and other purposes should be controlled and adjusted through the established governance mechanism of member cooperatives that are also the shareholders and end-users (beneficiaries) of the central cooperative banks, taking into account the financial positions of both the central cooperative banks and the member cooperatives.
(5) Liquidity Requirements		
a Positioning of the liquidity	**"Strengthening the resilience**	・ Liquidity risk profile is rather unique to each financial institution

requirements	**of the banking sector" 50～56** **"International framework for liquidity risk measurement, standards and monitoring" 1～6**	and, therefore liquidity requirements should be positioned as Pillar2 requirements. ・ Liquidity risk profile largely depends on business models of different types of financial institutions such as commercial banks, investment banks, and settlement banks. Accordingly, the required size of the liquidity buffer for each financial institution is to be determined by the risk management frameworks that they have established. Therefore, an approach based on a one- size-fits-all set of metrics will not work in liquidity risk management without causing significant distortions. ・ One of the factors that are believed to have prevented liquidity risk from materializing among Japanese banks during the recent financial crisis is the effectiveness of thorough and detailed liquidity management practices made possible by the close communication that has been held between supervisors and individual financial institutions on a daily basis. With such reality in mind, liquidity requirements will work better if they are included in the Pillar2 requirements. ・ Liquidity-related standards are going to be introduced on a global level for the first time. Therefore, a trial period of at least a year should be established prior to their official introduction so that all of the parties concerned will be able to improve their understanding on trends, assessments and other metrics relating to the liquidity information.

b Treatment of deposits at the central cooperative banks from its membership banks on the calculation of liquidity ratio	**"International framework for liquidity risk measurement, standards and monitoring" 41〜56 82〜86**	• The Bank strongly requests inclusion of a clear statement in the standards, providing that the calculation of liquidity ratios with respect to deposits at the central cooperative banks from their membership cooperatives will be based upon the original deposit attribution at the membership bank (unit coop) level. • Although immediate depositors of the central cooperative banks are "financial institutions" in form, funds are deposited with the umbrella organization based on the distinctive organizational characteristics of the cooperative banking system. Under the cooperative banking system, each unit cooperative bank takes household retail deposits from its individual member (i.e. farmers, etc.) and deposits the funds internally within the group in a hierarchical fashion. The central cooperative banks use these funds to provide appropriate financial intermediation within the group as well as to manage the funds efficiently. Therefore, the deposits at the central organization from its membership cooperatives are as stable as the primary customer attribution (i.e. aggregation of small retail accounts). • In addition to the aforementioned characteristics, the cooperative bank system under the umbrella of the Bank has reinforced disciplinary regime to ensure the stability of deposits from member cooperatives to their umbrella organization. • In fact, the requirements for minimum deposits from member

		cooperatives to their umbrella organization have been set within the group's Basic Policy under the provisions of the law for JA Bank Group System, which is known as the "Act on Enhancement and Restructuring of the Credit Business Conducted by The Norinchukin Bank and Specified Agricultural and Fishery Cooperative Savings Insurance Cooperation". Almost all member cooperatives have instituted the minimum deposit requirements into their Articles of Incorporation. Furthermore, as deterrence to non-compliance, the System can take an action to expel any member who can not keep the requirements constantly. Supported by those well-disciplined frameworks, the flows of funds between the member banks and the Bank have been highly stable. ・ Based on the above, the Bank considers it appropriate that the deposits at the central cooperative banks on the calculation of the liquidity ratio should be based upon the original deposit attribution at the membership cooperatives (unit coop) level.
c Liquidity-related information disclosure	**Same as above 135**	・ Liquidity risk-related information may incur reputational risk. Therefore, its information should not be disclosed until markets acquire the ability of accurate interpretation of liquidity risk-related data. ・ The Bank supports the idea of enhanced disclosure of liquidity risk-related information to the supervisors. However, casual disclosure of liquidity risk-related information before markets acquire

		the ability of accurate interpretation may expose financial institutions to both reputational risk and the risk of unexpected and excessive market dynamism.