

June 21, 2013

Comments on the Basel Committee on Banking Supervision's Consultative Document:  
Recognising the cost of credit protection purchased

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on the consultative document: *Recognising the cost of credit protection purchased*, released on March 22, 2013 by the Basel Committee on Banking Supervision (the "Committee").

We hope that our comments below will be of assistance and perhaps offer an additional point of reference as you work towards finalizing the rules proposed by the Committee.

#### **General Comment**

- We understand that this proposal is targeted on the credit protections whose premiums are high relative to the amount of the exposures being protected, purchased with the intention of engaging in regulatory arbitrage. This proposal, however, requires additional capital charges even to transactions with no intention of regulatory arbitrage or no such high premiums involved, thereby imposing an excessive and unnecessary operational burden from the policy standpoint.
- Rather, instead of introducing a one-size-fits-all regulatory framework under Pillar 1, we respectfully suggest that this framework should be introduced as a supervisory guidance under Pillar 2 that accommodates circumstances unique to each jurisdiction and the characteristics of each transaction. The proposed approach imposes additional capital charges to all transactions that meet certain criteria through Pillar 1 including transactions that should be out of the scope of this proposal in light of the objective of the regulation. Our concerns, therefore, are that such treatment may force firms to assume regulatory costs, or excessive operational burden which are disproportionate to the benefits the regulation provides, and could create a disincentive for firms to implement credit management activities in an agile manner.

## Specific Comment

**Q1 In addition to the 150% risk-weight threshold, should additional exemptions for certain types of transactions be considered? In particular, the Committee welcomes feedback on (1) exposures guaranteed by governmental entities (including sovereigns and public sector entities) and (2) trade finance transactions with guarantees.**

As noted in the General Comment, our opinion is that the cost of credit protection purchased should be addressed by Pillar 2. However, if the regulation is applied under Pillar 1, it should be established considering the following:

- All exposures guaranteed by governmental agencies should be exempt. Originally, governmental agencies design their guarantee schemes to meet their own policy objectives that stimulate funding to the market. Given such an objective, guarantees by governmental agencies are not considered to provide regulatory arbitrage opportunities.

With regard to (2) trade finance transactions with guarantees, such transactions are based on actual transactions executed by customers in the ordinary course of business, and hence the possibility of regulatory arbitrage is considered to be low. Therefore, it is reasonable to exempt this type of transaction.

Further, exempting the above transactions where there is no intention to arbitrage could reduce unnecessary operational costs, including reviewing regulatory risk weights at the time of executing guarantee, creating databases for spread income and premiums, and calculating present value on a quarterly basis.

- We support the proposed option to take into account spread income when calculating the present value of material credit protection costs as stated in “Technical Guidance (1.2) Recognising spread income”. If spread income is not considered, transactions with economic rationality, earning premium sufficient to cover risk, may be unduly penalized.
- The introduction of this regulation is expected to have an impact on current risk management practice and customer relationships of firms and may require the development of a framework including developing a system for screening new guarantee transactions. Hence, we respectfully request BCBS to set a transitional measure that mitigates drastic changes arising from the regulation and a sufficient lead time.