

June 30, 2017

Comments on the consultative document: *Global systemically important banks – revised assessment framework*, issued by the Basel Committee of Banking Supervision

Japanese Bankers Association

We, the Japanese Bankers Association (“JBA”), would like to express our gratitude for this opportunity to comment on the consultative document: *Global systemically important banks – revised assessment framework*, issued on March 30, 2017 by the Basel Committee on Banking Supervision (“BCBS”).

We respectfully expect that the following comments will contribute to your further discussion.

[Executive summary]

We support the objective of the global systemically important banks (“G-SIB”) assessment framework to introduce incentives for banks to change their risk profile, etc. in ways that reduce their systemic spillover effects when they fail.

With respect to the proposed revisions to the G-SIB framework discussed in the Consultative Document, we agree with the revisions made from the perspective of ensuring a level playing field or capturing risks more appropriately. However, sufficient lead time should be provided to allow banks to develop a system for accurate aggregation of figures that will be required under the revised assessment framework.

Furthermore, for the introduction of short-term wholesale funding (“STWF”) as a new indicator presented as an issue for discussion, we oppose to it primarily due to the reason that it is not necessarily appropriate given that the BCBS’s publication in July 2013 states that systemic importance should be measured in terms of the loss-given default (“LGD”).

In addition to the revisions proposed in the Consultative Document, we request the BCBS to review the methodology when in converting to Euro that are used for scoring purposes (i.e. currently, spot rate as of the end of December). In particular, a fair methodology that minimises the impact of a foreign exchange on scoring, such as “leveling of foreign exchange rates” by using an average of foreign exchange rates over one or several years should be adopted.

[Specific comments]

1. Removal of the cap on the substitutability category

We support the BCBS's proposal to remove the cap on the substitutability category.

The current framework applies a cap only on the substitutability category in consideration of effects on some specific financial institutions. This results in a highly skewed framework which contradicts a level playing field and is inappropriate for measuring the degree of systemic risk of financial institutions.

2. Expansion of the scope of consolidation to include exposures under insurance subsidiaries

We support the BCBS's proposal to expand the regulatory scope of consolidation in G-SIB framework to include exposures from insurance subsidiaries in G-SIB category.

Similarly to the BCBS, it has been our concern that the risks presented by insurance subsidiaries of banking groups are not even captured by both the G-SIB and globally systemically important insurers (G-SII) frameworks. With the revision proposed in the Consultative Document, those risks stemming from insurance subsidiaries of banking groups should be covered.

3. Inclusion of a new indicator of trading volume in the substitutability category

If this indicator is to be added, its definition should be clarified and a sufficient lead time should be provided to develop a necessary system.

If the term "trading volume" (e.g. the treatment of trades via central counterparties ("CCP")) is not specifically and explicitly defined, differences in interpretation may result in inconsistent reporting across financial institutions. Therefore, the definition of "trading volume" needs to be carefully considered and determined.

As some financial institutions have not necessarily developed a sufficient system for calculating the trading volume, they will need a reasonable amount of time (i.e. at least approximately three years given the situation at the time of implementing the G-SIB assessment framework) for developing a necessary framework (e.g. in-house system developments and the establishment of internal procedures, and dry-run) in order to ensure complete and accurate aggregation.

4. Inclusion of a new indicator for short-term wholesale funding ("STWF")

The BCBS should not introduce STWF as a new indicator for the reasons

described below.

Firstly, the size of STWF mainly affects the probability of default (“PD”). On the other hand, views on how it affects LGD vary as described in the Consultative Document. The document, “*Globally systemically important banks: updated assessment methodology and the higher loss absorbency requirement*,” issued by the BCBS in July 2013 sets out that global systemic importance should be measured in terms of the impact that a bank’s failure can have on the global financial system and wider economy (i.e. LGD), rather than the risk that a failure could occur (i.e. PD). In light of the concept of the G-SIB assessment framework where each bank’s systemic importance is measured in terms of LGD, adding the STWF as a new indicator would not necessarily be appropriate because the impact of the size of STWF on LGD is not sufficiently identified.

Secondly, since STWF is already controlled by existing liquidity requirements (e.g. Liquidity Coverage Ratio (“LCR”)), it would lead to regulatory overlap if the STWF is used as an indicator for assessing G-SIBs.

With the proposed STWF indicator, we are concerned that, for example, it is not possible to distinguish repo transactions secured by U.S. treasury bonds from unsecured large deposits or interbank transactions, and thus the use of the proposed indicator may unintentionally result in imposition of a penalty even on highly-stable transactions. Moreover, as most of STWF are assumed to be interbank transactions, it may overlap with indicators in the interconnectedness category. Given this, if it is determined to include the STWF indicator, the BCBS needs to take certain measures to address the above concerns, such as setting categories in accordance with the degree of funding risks and by multiplying its weight to each category.

Also in the U.S. where the STWF indicator has already been introduced in the G-SIB capital surcharge framework applied to U.S.-based G-SIBs, the Report to President Trump issued by the U.S. Department of the Treasury on June 12, 2017 provides a recommendation to review the framework for the U.S. G-SIB capital surcharge, including removal of STWF. Therefore, in consideration of this movement in the U.S., the BCBS will also need to carefully discuss the proposed inclusion of the STWF indicator from the perspective of global regulatory harmonisation.

5. Exchange rate to Euro applied for scoring purposes

The BCBS should adopt a fair methodology that minimises the impact of a foreign exchange on scoring in regards to the methodology used when in converting to Euro, for example, enhancing the stability and predictability through “leveling of foreign exchange rates” using an average of foreign exchange rates over one or several years, instead of the current spot rate as of the end of December.

Since systemic importance does not vary by daily foreign exchange rates, the scores used for G-SIB assessment purposes should minimise the impact of fluctuation of exchange rates and focus on the stability and predictability. With a view to addressing the too-big-to-fail (“TBTF”) issue, it is preferable that G-SIBs identified through that methodology will be encouraged to strengthen self-directed controls over those transactions that are important for the financial system, etc.

Financial market volatility may overshoot when geopolitical risks materialise or in other similar cases. As a result, volatility of foreign exchange rates could have an extremely significant impact on scoring results under the current rule which requires the application of the spot rate for scoring purposes, as shown in the table in *Appendix* as below. This may undermine the identification of the level of actual effects on the financial system, including activities during the period.

Even though financial institutions undertake self-reliant efforts to reduce the score of important assessment indicators for the financial system, in other words, to mitigate systemic risk, they will be significantly affected by an impact from the foreign exchange market which is an external factor. This could lead to a situation that disincentivises financial institutions to reduce risks.

Furthermore, in terms of the impact of volatility of foreign exchange rates on scoring, there is a level playing field issue between financial institutions in those jurisdictions adopting Euro as an underlying currency and other financial institutions.

Given the above, in order to enhance the stability and predictability of the scores used for the G-SIB assessment purposes, incentivise financial institutions’ self-directed risk reduction efforts and ensure the level playing field across jurisdictions, the BCBS should adopt a fair methodology with respect to the converting to Euro used for scoring purposes so that it can minimise the impact of foreign exchange on scoring through “leveling of foreign exchange rates” as discussed above.

[Appendix]

<Impact of exchange rates on the score of Japanese banks (Estimation)>

		Applied exchange rate (EUR/JPY)						
		BCBS rate (As of Dec. 31, 2015)	Daily rate			3-year moving average rate		
			Highest over the latest 2 years※1	Lowest over the latest 2 years※1	Gap between the scores at the highest and lowest rates	Highest over the latest 2 years※1	Lowest over the latest 2 years※1	Gap between the scores at the highest and lowest rates
			131.07	111.11	140.57	127.85	135.31	
Score (estimate)※2	Company A	269	318	251	67	276	261	15
	Company B	167	198	156	41	172	162	9
	Company C	154	182	144	38	158	149	9
	Company D	102	120	95	25	105	99	6
	Company E	105	124	98	26	108	102	6
	Company F	60	71	56	15	62	58	3

*1: The highest rate and the lowest rate during the period between May 18, 2015 and May 17, 2017 (Bloomberg: BGN rate).

*2: It is assumed that the denominator applied to calculate scores remains the same (BCBS published rate).