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Basel Committee on Banking Supervision (BCBS)
Basel, Switzerland

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***JCR's Comments on the Second Consultative Document by the BCBS regarding
Revisions to the Standardised Approach for credit risk***

We, Japan Credit Rating Agency, Ltd. (JCR), would like to express our gratitude to the Basel Committee on Banking Supervision (BCBS) for giving us an opportunity to submit our comments on the Second Consultative Document regarding *Revisions to the Standardised Approach for credit risk* (SCD).

JCR is an eligible external credit assessment institution (eligible ECAI) in Japan for its regulations on banks' capital adequacy ratio. JCR is also a credit rating agency registered by the Financial Services Agency (FSA) in Japan as well as the Securities Exchange Commission (SEC) in the United States.

Our comments on the SCD are attached to this letter. Among all the issues raised by the SCD, we particularly focus on (a) Risk weight for banks' exposures to banks and (b) Due diligence requirements for banks. We hope our comments could, through deliberations at the BCBS, facilitate the international effort to strengthen the banks' capital framework.

Yours sincerely,

/s/

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A. Risk weight for banks' exposures to banks

1. The Second Consultative Document (SCD) advocates that, in determining a risk weight for banks' exposures to banks, those external ratings that assume implicit government support must not be used. JCR is of the view that, in order to accurately apply the risk weight that reflects the risks entailed in banks' exposures to other banks, those external ratings with the assumption of implicit government support should continue to be used.
2. This is because we recognize that, despite the global attempts to stave off the "Too big to fail" issue, there still exists, in not a few jurisdictions, an institutional framework by which the government renders financial support to troubled banks and such framework continues to stand ready to be triggered as needed. In such jurisdictions, probability and magnitude of losses in exposures to banks, especially financially vulnerable banks, may be highly contingent upon government support. In such cases, should the use of external ratings with the government support assumption be ruled out, it could cause unjustifiable discrepancy between actual risks and the applied risk weight.
3. We understand that there may be two motives behind this attempt: (a) to reduce the linkage between the risk weight for exposures to banks and the sovereign ratings and (b) to minimize variations in risk recognition among different approaches. The objective (a) could be achieved by terminating the national discretion to allow an application of one lower risk weight to exposures to banks than those to their sovereign as proposed in this SCD. The other purpose (b) could also be attained by allowing the assumption of implicit government support in both of the External Credit Risk Assessment Approach (ECRA) and the Standardized Credit Risk Assessment Approach (SCRA).
4. We would also suggest that, in case the use of external ratings without the assumption of implicit government support is prohibited, the term "implicit government support" be more clearly defined, perhaps by adding illustrated examples, so as to forestall possible confusions in interpretation and resultant variations in treatments among different jurisdictions.

B. Due diligence requirements for banks

5. JCR believes that careful deliberation may be needed further on the introduction of banks' mandatory due diligence requirements over the external ratings for their exposures to banks and corporates as proposed in paragraphs 17 and 33 in the Annex of the SCD.

6. This is because, should the due diligence requirements be imposed, majority of banks may likely make comparisons between the external ratings and their internal risk evaluations as their due diligence analysis. Given that the methodologies of each bank's internal risk evaluation inevitably differ from one bank to another, the results of such due diligence analysis, even over the same external rating, could often vary among banks. In our view, the SCD's proposal to allow different approaches to be applied for both of the jurisdictions where the external ratings are used and not used could already constrain cross-jurisdiction comparability. The obligatory due diligence analysis for banks could further exacerbate this challenge by making it more difficult to compare risk weighted capitals even among banks within the same jurisdiction.

7. In addition, in order not to mislead the stakeholders on the intentions of this proposal, we suggest amending or deleting the following sentence in paragraphs 17 and 33 regarding the due diligence analysis: *"Banks must perform due diligence to ensure that the external ratings appropriately and conservatively reflect the creditworthiness of the bank counterparties (/the counterparties)."*

8. This is because, in our understanding, the goal of the due diligence requirements in paragraphs 17 and 33 may be that, in case when the external rating-driven risk weight is deemed unjustifiably low, banks ought to apply those risk weights derived from the risk assessment conducted on their own or by a third-party instead. This could be fully understood by paragraphs 14 and 32 alone. Nevertheless, we are afraid that the above sentence, if it remains, might drive banks to put an excessive emphasis on assessing the external ratings. Of course, there is no denying that it would be important for banks to properly understand the rationale and background of the external ratings for the banks' risk management. That said, overemphasis on the evaluation of external ratings, especially where no established methodologies exist to evaluate external ratings, could constrain banks' operational efficiency. Furthermore, eligible ECAs could also be overwhelmed by a large number of questions and information requests by each and every bank. We are concerned that this could not only hamper the efficient operation of the eligible ECAs but also bring about unintended negative implications in terms of the quality of external ratings that are assigned by such ECAs and used in this standardized approach.
