Comments on the Basel Committee on Banking Supervision discussion paper “Regulatory Treatment of Accounting Provisions”

The National Association of Shinkin Banks[1]

January 12, 2017

We appreciate the Committee’s affording us an opportunity to comment on its discussion paper “Regulatory Treatment of Accounting Provisions.”

Japan’s shinkin banks are established and operate under Japanese law as cooperative financial institutions in specifically defined geographical regions within Japan, their clientele restricted in principle to small and medium enterprises and individuals. With a history going back over 70 years, the National Association of Shinkin Banks is the umbrella organization for the nation’s 265 shinkin banks as well as the Shinkin Central Bank.

We hope the Committee finds our comments helpful in its review of the regulatory treatment of accounting provisions.

Comment:

We understand that the proposals put forth in this discussion paper are intended to harmonize the diverse national accounting practices and standards and to move toward a more level playing field, and it is in that spirit that we support retaining the current regulatory treatment (as per discussion paper paragraph 2.1), including the distinction between general provisions (GP) and specific provisions (SP).

[1] As of March 31, 2016, Japan’s 265 shinkin banks had JPY134 trillion in deposits, JPY67 trillion in loans outstanding, 110,000 employees, and 9.27 million members. The Shinkin Central Bank had total funds of JPY30 trillion and employed 1,199 people.

Reasons:

1. The current definitions should be retained so as to avoid increasing the operational burden on small and medium financial institutions.

   Provisions applying to financial institutions adopting the standard approach (SA) should be made and kept as simple and effective as possible.

   The SA is employed by many small and medium financial institutions, and requiring such institutions to use a method for calculating provisions under the Basel regulatory framework that differs from their usual accounting procedures would impose an additional operational burden on them. The added expense of satisfying these regulations would in turn weaken their ability to function as financial intermediaries and thus be detrimental to their client base.

2. We object to more explicit definitions of provisions because such more explicit definitions create incompatibilities with national accounting practices.

   The thinking underlying paragraph 60 of the Basel III regulatory framework[2] seems the most rational approach to reserve equity capital and is compatible with the way Japanese accounting standards handle reserve funds.

   We thus believe definitions of reserve capital as found in the current Basel standards should be maintained as are.

3. Because bringing expected losses (EL) into the equation does nothing to enhance the comparability of financial institutions,

[2] That paragraph reads, in part, "Provisions or loan-loss reserves held against future, presently unidentified losses are freely available to meet losses which subsequently materialise and therefore qualify for inclusion within Tier 2. Provisions ascribed to identified deterioration of particular assets or known liabilities, whether individual or grouped, should be excluded."

we would oppose this.

It is suggested that EL be employed to calculate provisions, but the fact that EL rates are set on a country-by-country basis belies the claim that EL enhance financial institution comparability.

Institutions that have adopted the SA tend to be smaller financial institutions or more regionalized institutions than those that have adopted the internal rating-based (IRB) approach, which means there is a greater spread and diversity in the characteristics of their exposures, their probabilities of default (PD), and other factors.

Because PD in particular varies considerably depending upon the borrower's industry, region, and scale, applying one specific fixed EL ratio assigned to each risk weight by some outside authority would not facilitate calculating accurate ELs in term of each institution's base.

In light of this situation, even if EL is adopted, it will not link to any real enhancement of comparability between those financial institutions that employ the SA and those that use an IRB approach.

Given the above, we believe retaining the Basel framework's current definitions and treatment for provisions unchanged (as proposed in paragraph 2.1 of the discussion paper) is the most reasonable course.