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May 11, 2017

*Comments on Proposed Framework for Post-Implementation Evaluation
of the Effects of the G20 Financial Regulatory Reforms*

Japanese Bankers Association

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on *Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms* issued on April 11, 2017 by the Financial Stability Board (“FSB”). We respectfully expect that the following comments will contribute to your further discussion.

[General Comments]

We are willing to cooperate with the evaluation of the effects of the regulatory reforms using an internationally unified approach as proposed in the consultation document, since such an evaluation would be meaningful in this transitional stage of shifting from the post-crisis stage of developing reforms to the stage of implementing and monitoring these reforms.

Capital and liquidity frameworks under Basel III, margin and other regulations have already been implemented; however, a number of reforms are expected to be implemented going forward. In such a situation, it may take time to have a comprehensive view on the effects of those regulatory reforms. Given this, the scope of this evaluation should cover broader reforms, including not only those reforms already implemented but also those upcoming reforms that may have significant effects on the financial markets and the real economy.

We understand that the FSB will evolve its evaluation framework which has just been initiated in the process of its continuing evaluation of effects. We respectfully request the FSB to share details of, for example, what kind of framework or data is used to evaluate, and what analysis outcome was obtained in the form of a public consultation, with stakeholders including authorities and related industries.

Those reforms, which have unintended adverse consequences or which have not

demonstrated intended consequences should be reviewed and revised as necessary through an initiative led by the FSB.

Although this framework is a very important topic, the consultation period provided is only one month, which is very short and not sufficient to invite meaningful feedback from various stakeholders.. We expect the FSB to establish an appropriate public consultation process for collecting opinions (e.g., establish a comment collection system or “opinion box” to invite comments at all times, not only during the consultation period) and ensure continued dialogue with stakeholders in order to obtain cooperation from them for improving the evaluation framework going forward.

[Specific Comments]

<<Responses to the questions>>

Questions 1 to 3 (Main elements of the framework)

1. Do you have any comments or suggestions on the main elements of the evaluation framework (e.g. are there other elements that should be considered for inclusion in the framework)?
2. Are the objectives and scope of the framework appropriately set out?
3. Would you suggest any refinements or additions to the concepts and terms?

(Responses)

- ✓ We basically support the objectives and the concept underlying the evaluation of effects as stated in the consultation document.
- ✓ The scope of evaluation, however, should not be limited to implemented reforms, and should include those reforms to be implemented that may trigger changes in behavior of market participants and users in anticipation of the implementation and thus may have impacts on the financial markets and real economy. An approach would, for example, be to capture effects of reforms to be implemented through carrying out a qualitative survey.

Questions 4 to 6 (Challenges of evaluations)

4. Do you have comments or suggestions on how to address the challenges of identifying and measuring interactions between reforms and how to isolate the effects of reforms and their interactions from other factors?
5. Do you have views on how to think about intended versus unintended (and possibly

undesirable) consequences or how to frame the trade-off between different (and possibly competing) objectives?

6. Do you have comments or suggestions on how to address the challenges of defining and measuring social benefits and costs, especially when they do not follow directly from private benefits and costs?

(Responses)

- ✓ With regard to “evaluation of overall effects” specified in page 7 of the consultation document, it is difficult to evaluate whether effects have met this evaluation criterion because the objectives set by G20 financial regulatory reforms (i.e., achieve strong, sustainable and balanced growth) which are criteria for evaluating effects are still high-level and ambiguous. In addition, currently observable data includes, for example, costs for regulatory compliance efforts incurred by individual financial institutions, the movement in transaction volumes observed in markets, and a change in market participants. The work that can be carried out based on such data would be limited to, among other things, (i) the identification and summarization of key changes occurred after the implementation of reforms, and (ii) screening of reforms that could be a cause. We therefore believe that it is essential to have numerous continued discussions between the private and public sectors with regard to what evaluation criteria specifically mean and a practical assessment methodology and develop common understanding.
- ✓ For “measuring benefits” set out in page 7 of the consultation document, the issue would be how to measure benefits of respective reform if there are several reforms with the same objective. (For example, how to measure benefits arising from the central clearing requirements and benefits arising from the leverage ratio in the light of the objective to limit excessive derivatives transactions.) It is however difficult to objectively isolate and quantify the degree of effects (e.g., a reform has reduced the probability of financial crisis by xx%). Since this model-based evaluation method has certain limitations, a well-balanced evaluation framework should be established by taking into account the result of qualitative survey.
- ✓ For “prioritization of evaluations” described in page 9 of the consultation document, decisions need to be made on the basis of materiality which is the relative importance of the reform. To this end, it would be necessary to constantly monitor and change the priority because the degree of changes both in an event, which is a basis to evaluate the materiality, and by an impact resulting from the factors other

than regulation differs depending on a situation. If, for example, a significant change occurs in the “liquidity of a sovereign bond secondary market,” it would be necessary to investigate the magnitude of effects arising from reforms and those from a change in the level of interest rates, in order to make a robust analysis.

Questions 7-9 (Evaluation approaches)

7. Do you have comments or suggestions on the proposed evaluation approaches (i.e. on the empirical models and methods to analyze effects)?
8. Do you have suggestions on approaches to ensure the quality and replicability of results?
9. Do you have views on lessons – in terms of methods and approaches – that can be learned from evaluations in other policy areas, or from existing national or regional evaluation frameworks?

(Responses)

- ✓ Effective measures in addressing the question “Attribution” provided in page 10 of the consultation document would be to summarize logical consequences of reforms. For example, Liquidity Coverage Ratio would provide an incentive to hold more high quality liquid assets (HQLAs), while Leverage Ratio would prompt to limit HQLA holdings. It would also be considered effective to have continued dialogues with financial institutions about the impact on their business plan resulting from the regulation and the outlook of market conditions.
- ✓ We agree with the importance of the notion of “Heterogeneity” described in page 10 of the consultation document. Given the objective of “enhancing the stability and robustness of a global financial system,” the size, market share and other factors of financial institutions should be taken into account in terms of prioritizing the work or improving efficiency. For example, it would be considered useful to select the reform, which has the same regulatory requirements but cause different effects, observed in jurisdictions where global systemically important financial institutions (G-SIFIs) undertake their core businesses, or the reform, which has different regulatory requirements across jurisdictions in spite of the existence of the international agreement.
- ✓ We believe that it is necessary to combine both the deductive and inductive approaches, rather than to pre-define their weights, because, at this moment, evaluation criteria are not clear and the degree of effects is difficult to quantify. It

would be beneficial, for the deductive approach, to develop hypotheses and carry out data validation, and, for the inductive approach, to presume factors from observed changes (e.g., market transaction volumes, volatility and the number and the classes of market participants) and the assessment of effects on the objectives. The evaluation of reform effects has just been initiated and no specific benchmark has yet to be defined. It is considered effective to monitor data and facts with eliminating bias and to analyze a business plan developed by financial institutions so that effects that have not yet been materialized as outcomes can be captured.

- ✓ In terms of “Evaluation tools” discussed in page 12 of the consultation document, we agree with the method of Partial/General Equilibrium Analysis since this method is considered theoretically appropriate in terms of identifying the comprehensive influence from the reform. Furthermore, from practical perspective, it is unknown whether the method of Partial/General Equilibrium is useful or not since it has characteristics of limited data availability and difficulty in the empirical approach (i.e., it is empirically impossible to cease some of the regulations to observe the effects). It is therefore desirable to continue the study for this analysis with taking into account that the conclusion by this analysis merely represents the result based on hypotheses.
- ✓ As stated in “Transparency” in page 15 of the consultation document, we welcome the proposal to have an opportunity to seek public comments on the outcome of the evaluations by the FSB. Reviewing whether the outcomes are appropriate from various viewpoints would enhance the reliability and accountability of the outcome of the evaluations.
- ✓ For “Follow-up” noted in page 15 of the consultation document, if, as a result of the evaluation, it is identified that a reform needs to be reviewed because the intended objective is not reached or unintended consequences have occurred, such a reform should be promptly revised. The consultation document states that “results of evaluation reports will be sent to the relevant body,” but does not specify that “policy proposal will be made based on the outcomes of evaluation.” If, however, there are adverse consequences on the real economy, appropriate revisions to reforms should be immediately made at the initiative of G20. We respectfully request the FSB to play a proactive role in such a process.

Question 11 (Engagement with stakeholders)

11. How can the FSB and SSBs best engage with external stakeholders (e.g. financial services providers, various kinds of end-users, and academics) in their evaluation work (going beyond public consultations)?

(Responses)

- ✓ The evaluation of reform effects needs to be undertaken by smoothly collaborating with various stakeholders including private financial institutions and end users. In doing so, cooperation of stakeholders can more easily be obtained by, for example, avoiding duplication of exercises with the Regulatory Consistency Assessment Programme (“RCAP”) undertaken by the Basel Committee on Banking Supervision (“BCBS”) and those assessment conducted by international bodies such as the International Monetary Fund (“IMF”).
- ✓ The public and private sectors need to have deeper discussions about any abstract descriptions in the consultation document. For example, it is necessary for relevant parties to promote mutual understanding about the meaning of the intended objectives set by G20 which are the basis of evaluation criteria and the evaluation standards for Attribution and Heterogeneity.

Question 12 (Prioritisation of topics)

12. Do you have comments or suggestions on which individual reforms or interacting set(s) of reforms should be initially considered for evaluation as a matter of priority?

(Responses)

- ✓ The useful approach for the evaluation of effects would be to prioritize those reforms that may have adverse consequences, regardless of those already implemented or to be implemented. An approach to identify the reform that may have adverse consequences would be to identify overlapping reforms with the same objective. For example, a transaction may be subject to a regulation of a certain jurisdiction based on the attribute of a counterparty (such as, US Person or Canadian Person), or may be subject to a regulation of another jurisdiction depending on a physical location (e.g., a location where a transaction is executed) or the nature of a transaction (a transaction denominated in a certain currency). Furthermore, among the reforms expected to be implemented in the future, one of the objectives of output floors and the leverage ratio requirements is to serve as back-stop of the risk-based capital requirements. While, one of the objectives of

large exposure framework and TLAC holdings frameworks is to prevent the contagion of risks. These are the examples of the regulations which have the same objective.

- ✓ There are also regulations that have adverse effects. For example, Leverage ratio may discourage compliance with Liquidity Coverage Ratio that requires to hold high-liquid assets and liabilities with a low run-off ratio, such as deposits. The leverage ratio requirements may also prevent the facilitation of the use of central counterparties.
- ✓ Such an evaluation of the consistency between financial regulations should be led by an international body such as the FSB.