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Comments on the Financial Stability Board's Consultative Document
"*Adequacy of loss-absorbing capacity of global systemically important banks in resolution*"

Japanese Bankers Association

We, the Japanese Bankers Association, would like to express our gratitude for this opportunity to comment on the consultative document "*Adequacy of loss-absorbing capacity of global systemically important banks in resolution*" released by the Financial Stability Board (the "FSB").

With regard to this issue raised in this consultative document, we have been requesting considerations of resolution regimes of each jurisdiction, the consistency with resolution strategies and with other regulations such as Basel, and various resource of funding by banks. We hope that our comments below will be of assistance and offer an additional point of reference as you work towards finalising the rules.

The following section discusses our responses to specific questions.

<<1: Our Responses to Questions>>

Question 1 Is a common Pillar 1 Minimum TLAC requirement that is set within the range of 16 – 20% of risk-weighted assets (RWAs), and at a minimum twice the Basel III leverage requirement, adequate in the light of experiences from past failures to support the recapitalisation and resolution objectives set out in this proposal? What other factors should be taken into account in calibrating the Pillar 1 Minimum TLAC requirement?

Minimum TLAC requirement that is set at 16% of risk-weighted assets (RWAs) is considered to be more than sufficient.

For global systemically important banks ("G-SIBs"), in order to address Too-Big-To-Fail problems, (1) enhancement to regulatory framework for preventing failure of G-SIBs, (2) enhancement to effectiveness of supervision, and (3) development of orderly resolution regimes have been considered and sequentially implemented since the financial crisis. The minimum TLAC requirement should be determined on the basis of these initiatives.

(1) Enhancement to regulatory framework for preventing failure of G-SIBs
G-SIBs are required to enhance prudential capital and liquidity under Basel III through improving quality and quantity of its capital and implementing the leverage

ratio, the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) requirements, as well as to maintain higher capital with a surcharge added on to the capital requirement under Basel III (G-SIBs surcharge). Currently, the risk measurement approaches that aim to enhance transparency, simplicity and comparability are being considered for implementation, such as review of standardised approaches and capital floor.

(2) Enhancement to effectiveness of supervision

A review of supervisory practices, including proactive dialogue by supervisors with the board of directors, deepened understanding of business models, and expansion of risk governance and stress testing, is conducted in line with the "Recommendations for Intensity and Effectiveness of SIFI Supervision".

(3) Development of orderly resolution regimes

Various measures, including improvement in resolution regimes, cooperation among international authorities through supervisory college and Crisis Management Group (CMG), and the establishment of recovery and resolution plans (RRPs), are implemented in accordance with the "Key Attributes of Effective Resolution Regimes for Financial Institutions". At the same time, the introduction of protocol regarding a temporary stay of early termination rights for derivatives transactions by private financial institutions has been promoted.

Given the above developments, experiences from past failures would not necessarily be the case with future crisis. In other words, the application of TLAC requirement warranting excessive preparation taking into account past cases of incurring losses is not considered reasonable. Consequently, setting TLAC which is required to be maintained as resources available for loss absorption in resolution and for subsequent recapitalization at 16% of RWAs is considered to be more than sufficient.

This consultative document also proposes the introduction of an additional Pillar 2 TLAC requirement, and thus it would be appropriate to consider, as necessary, additional capital charge under Pillar 2, depending on business models and risk profiles of individual banks. Meanwhile, the implementation of leverage ratio-based TLAC requirement should be viewed as complementing the RWA-based TLAC requirement in order to ensure consistency with Basel 3, and regulatory treatment should be carefully considered once the Basel III leverage ratio requirements are finalized in future. Further, its level should not be "at least twice" the Basel 3 Tier 1 leverage ratio requirement, but either be defined in light of the quantitative impact survey ("QIS") and market impact survey results after the Basel III leverage ratio requirements are finalized, or set at a specific ratio of "6%".

Note: Some JBA members expressed their view on the implementation of leverage ratio-based

TLAC requirement. Specifically, they do not consider meaningful to provide two options for the denominator in calculating the TLAC requirement for a single numerator "TLAC" - one that uses the risk-weighted assets and the other that uses leverage exposures – since RWAs-based requirements and leverage exposure-based requirements are already introduced under the Basel III framework.

Question 3 What factors or considerations should be taken into account in calibrating any additional Pillar 2 requirements?

If the additional Pillar 2 requirements are applied, the level of additional requirement needs to be determined, considering the implementation of the supervisory and resolution regimes in the home jurisdiction and the business models and risk profiles of individual banks.

Question 4 Should TLAC generally be distributed from the resolution entity to material subsidiaries in proportion to the size and risk of their exposures? Is this an appropriate means of supporting resolution under different resolution strategies? Which subsidiaries should be regarded as material for this purpose?

It is requested to clarify the following in relation to Question 4:

(1) Distribution of TLAC within a group shall be permitted with some flexibility depending on, for example, the group structure, characteristics and business strategy, provided that loss absorption by the resolution entity is ensured. It is therefore requested to clarify that TLAC can be distributed either in the case where a resolution entity distributes TLAC to a material subsidiary directly or in the case where a resolution entity distributes via an entity other than a resolution entity.
For example, the regulation of foreign banking organization in the U.S. requires financial institutions meeting certain size criteria to establish an intermediate holding company. If a material subsidiary is determined on the basis of a consolidated based measure, and as a result both the intermediate holding accompany and its subsidiary are deemed as a material subsidiary, it is requested to avoid a situation where the parent company needs to distribute TLAC directly to both the intermediate holding company and its subsidiary.

(2) With regard to the quantitative criterion (5%), an entity for which it is difficult to apply the denominator of leverage ratio for certain reasons, for example, leverage ratio calculation is not required under local regulations, may use total assets as a simplified method; and

(3) Definition of the terms included in the quantitative criterion (5%), such as “regulated entity” and “revenues.”

Question 5 To what extent would pre-positioning of internal TLAC in material subsidiaries support the confidence of both home and host authorities that a G-SIB can be resolved in an orderly manner and diminish incentives to ring-fence assets? Is a requirement to pre-position internal TLAC in the range of 75 - 90% of the TLAC requirement that would be applicable on a stand-alone basis, as set out in the term sheet (Section 22), appropriate to satisfy the goals of the proposal and ensure that TLAC is readily and reliably available to recapitalize subsidiaries as necessary to support resolution? Can this pre-positioning be achieved through other means such as collateralized guarantees?

The level of internal TLAC requirement would need to be determined based on in-depth discussions between host and home authorities.
As the relationship between home and host authorities and national resolution regimes vary, the level and form of internal TLAC cannot be determined in a uniform manner. Accordingly, the TLAC level needs to be determined in a manner to avoid excessive burden being imposed on financial institutions through in-depth discussions between host and home authorities.

We support the proposal to include collateralized guarantees in internal TLAC-eligible liabilities.
This proposal enables a subsidiary that does not need funding support by its parent company to pre-position TLAC at a sufficient level without increasing liabilities. From this point of view, we support this proposal. Legal relationship of a guarantee agreement (e.g. the nature of a guaranteed obligation) however should be specifically defined.

In addition to above, it is requested to clarify the following in relation to Question 5:

(1) The concept and rationale underlying the determination of the level of internal TLAC requirement by host authorities

(2) The definition of “at the point of non-viability,” under which host authorities may trigger internal TLAC.

Question 6 Are the eligibility criteria for TLAC as set out in the term sheet (Sections 8-17) appropriate?

Firstly, the following discusses our comments on Section 11.
The term sheet 11 specifies that “[e]ligible external TLAC must have a minimum remaining maturity of at least one year.” Considering the objective of TLAC regulation to construct a

framework that is consistent with the Basel capital requirement, it is requested to clarify that Tier 2 instruments with a remaining maturity of less than one year that count towards the Basel III capital are also included in TLAC, irrespective of requirements under Section 11. Additionally, eligibility criteria for TLAC eligible-liabilities other than Tier 2 instruments with remaining maturity of less than one year should be permitted to be determined at national discretion, similarly to treatment of Tier 2 under Basel III.

The below provides our comments on Section 13.
The term sheet 13-c defines eligible external TLAC as "issued by a resolution entity which does not have excluded liabilities [as specified in the term sheet 12] on its balance sheet (for example, a holding company)". However, senior debts issued by the holding company are subordinated to operating subsidiary's ordinary liabilities, and such debts issued by the holding company do not undermine loss-absorbing capacity with the reasons shown in the below examples. In addition, it is not realistic to assume a pure holding company that does not have any liabilities other than proposed eligible-TLAC liabilities, and therefore is not practical to exclude from the TLAC eligible criteria a holding company holding liabilities listed below.
Consequently, it is requested to clarify that, even under a situation where a holding company has such liabilities, senior debts issued by the holding company could be qualified for TLAC. Additionally, it is considered reasonable for national authority to determine, at its discretion, the type of liabilities that would not undermine their loss-absorbing capacity in resolution, taking into account differences in legislative regimes.

(Example)

- Accrued expenses, etc., such as operating expenses, incurred in the normal course of business: These liabilities would be paid preferentially and separately in resolution proceedings
- Tax liabilities: These liabilities have priority over a lien under the civil code

Further, there might be cases where subsidiary securities firm holds TLAC-eligible corporate bonds and subordinated bonds, which are issued by its holding company, for market-making purposes, and it is impracticable for the holding company to assume holding liabilities which are further subordinated to those bonds. Thus, certain amendment with this section is requested in this regard as well.

Question 7
What considerations bear on the desirability of an expectation that a certain proportion of the common minimum Pillar 1 TLAC requirement consists of (i) tier 1 and tier 2 capital instruments in the form of debt plus (ii) other eligible TLAC that is not regulatory capital?

We understand the expectation that a certain proportion of TLAC should consist of liabilities specified above. We however oppose to incorporating this to the TLAC requirements.

Inclusion of debt ratio criterion in the composition of TLAC may incentivize banks to limit an increase in their capital ratio and to expand funding in the form of debts, and thus may have a negative impact from a prudential standpoint. It would therefore not be appropriate to incorporate in resolution regime a requirement that may cause inconsistency with prudential regulations.

Further, traditional commercial banks use deposits rather than corporate bonds as their primary funding sources. Implementation of debt ratio criterion may have an adverse impact on traditional commercial banks with such funding structure, while is favorable for investment banks which are dependent on wholesale funding. Such introduction therefore should be carefully considered in light of level playing field. Introducing a criterion favorable for investment banks may not only be extremely unfair, but also may undermine the funding structure of traditional commercial banks which are regarded as being highly safe and stable from perspectives of liquidity requirements.

Question 8
Are the conditions specified in the term sheet (Section 8) under which pre-funded commitments from industry-financed resolution funds to provide resolution funding contribute to TLAC appropriate?

Counting credible ex-ante commitments from authorities backed by pre-contribution of the industry towards satisfying the minimum TLAC requirement, as set forth in the terms sheet 8, is considered to be reasonable in light of the objective of the TLAC regulation. Therefore, we support this proposal.

As history of banking systems, financial markets and industry vary across jurisdictions, effective resolution regimes also differ from jurisdiction to jurisdiction. The treatments proposed in the term sheet 8 are considered reasonable in order to reflect such differences in resolution regimes and financial markets and ensure fair allocation of resolution cost on a global basis.

In Japan, the Deposit Insurance Corporation of Japan that satisfies the above conditions served to prevent contagion of crisis and contributed to maintaining the stability of Japan’s financial system in the past financial crisis.

Question 10
Do you agree that the TLAC requirement for G-SIBs should be integrated with Basel III such that the minimum TLAC requirement should be met first, and only after TLAC is met should any surplus common equity tier 1 (CET1) be available to meet the Basel III buffers?

Given that capital buffer functions as a buffer to maintain the capital ratio, it is natural to consider that the portion included in capital conservation buffer will first be used upon reduction in capital. We therefore agree with this proposal.

Question 11
What disclosures (in particular in terms of the amount, nature and maturity of liabilities within each rank of the insolvency creditor hierarchy) should be required by resolution entities and material subsidiaries to ensure that the order and quantum of loss absorption in insolvency and resolution is clear to investors and other market participants?

In relation to Question 11, it is requested to address the following:

(1) Disclosure of TLAC ratio and total TLAC-eligible liabilities by instrument at a reference date would be able to provide predictability of loss absorption to investors and market participants. The amount, nature and maturity of liabilities within each rank of the insolvency creditor hierarchy should therefore be unnecessary.

(2) Co-operation across relevant institutions, including FSB and BCBS, is requested in order to ensure that disclosure requirements under TLAC regulation do not overlap with those under Pillar 3 and other regulations to deliver a coherent framework as a whole.

Question 12
What restrictions on the holdings of TLAC are appropriate to avoid the risk of contagion should those liabilities be exposed to loss in resolution?

With a view to dispersing loss burden arising from failure of a G-SIB and liming the risk of contagion, a global framework has been established through enhancing the framework for controlling large exposures, and hence individual financial institutions have already been taking measures to address such requirements. Given this, at least, specific restrictions focusing only on TLAC should not be imposed on the holdings by financial institution other than G-SIBs.

The framework for controlling large exposures restricts exposures comprehensively at a group level, including affiliates. TLAC is included in exposures under this framework. Therefore, the reason why restrictions on the holdings focusing only on TLAC should be established is

not clear, and this merely increases the complexity of the regulation.
For stable TLAC funding, funding in home markets is critical, but the size of senior debts market and the degree of expansion in investor class significantly vary across jurisdictions. If restrictions on the holdings by financial institutions other than G-SIBs would be introduced, a concern will be raised that stable TLAC funding from home markets may be difficult in some jurisdictions. Accordingly, the introduction of such restrictions (including the application of risk weights for punitive purposes) needs to be considered carefully.

With regard to holdings between G-SIBs, it is considered appropriate to take certain measures such as applying more relaxed exclusion rules to temporary holdings for underwriting purposes.
In major jurisdictions, G-SIBs have very strong presence in capital markets for underwriting and market-making activities. It would therefore be necessary to implement certain measures, including applying more relaxed exclusions rules to temporary holdings for underwriting purposes and certain market-making activities, by reference to the treatments under Basel regulation, in order to ensure smooth issuance of TLAC-eligible instruments in the markets.

Question 13
Should G-SIBs be required to conform with these requirements from 1 January 2019? Why or why not? What, within the range of 12 to 36 months following the identification as a G-SIB, should be the conformance period for banks identified as G-SIBs at a future date?

From the standpoints of market capacity and investor protection, the conformance date of 1 January 2019 is considered to be too early.
Increasing TLAC-eligible instruments entails restructuring of issued senior bonds. The most practical option to achieve this is to refinance issued senior bonds to instruments that meet the TLAC eligibility criteria upon redeeming issued senior bonds. In Japan, since the scale of senior bonds market is the annual issuance of approximately JPY8 – 10 trillion, it requires a considerable period of time to replace senior bonds issued by 3 G-SIBs with TLAC-eligible instruments even assuming that issuance in a new form can be executed immediately.
It is also crucial to consider the comformance period from the standpoints of both the bond-issuers side and the investors side that begin to invest in new instruments. In other words, as TLAC-eligible instruments have product features different from issued senior bonds, in issuing TLAC-eligible instruments, the market needs to be developed through providing sufficient education to investors from a standpoint of investor protection. For issuance of Basel III-eligible Tier 2 instruments, it required approximately three years to educate investors and then actually issue Tier 2 insturments since finalization of the rules This market is still under development. Similary to this case, the implementation of TLAC-eligible instruments, including eduction of investors and subsequent market development, would

require a considerable period of time.

Given the above, the conformance date of 1 January 2019 is considered to be too early. Under the Basel III capital requirement, a period of approximately eight years was set from finalisation of the rules to full implementation. Taking into account such implementation case, it is requested to consider postponing the conformance timing or permitting phase-in implementation.

In addition, it is requested to provide a lead time of at least 36 months (preferably 60 months or so) for a firm newly designated as a G-SIB after such designation in order to comply with the TLAC requirements. Similar lead time should also be provided to material subsidiaries newly selected in order for them to meet the level of internal TLAC requirement.

If the requirements would be applied without fully taking into account the impact of adoption, this may have an adverse impact on real economy through a decline in funding capacity of G-SIBs. Therefore, it is requested to determine a conformance period by duly considering the above discussion.

Question 14

How far is the TLAC proposal, if implemented as proposed, likely to achieve the objective of providing sufficient loss-absorbing and recapitalization capacity to promote the orderly resolution of G-SIBs?

The implementation of TLAC would adequately achieve the objective of providing sufficient loss-absorbing and recapitalization capacity. However, setting the level of TLAC requirement at 16% of RWA is considered to more than sufficient (See our response to Question 1).

Question 15

What will be the impact on G-SIB's overall funding costs of the adoption of a Pillar 1 Minimum TLAC requirement?

An impact on funding costs varies depending on the minimum TLAC requirement, eligible liability criteria, and conformance period. Funding costs may increase considerably primarily due to:

(1) Subordinated premiums for TLAC-eligible instruments

A shift from senior bond issuance by operating subsidiaries to issuance by a holding company will incur subordinate premiums, since credit rating will be changed due to a shift of an issuing entity from operating subsidiaries to a holding company and TLAC is virtually deemed as equivalent to subordinated debt. If investors and rating agencies have a negative view on TLAC-eligible instruments, funding costs will increase significantly.

(2) Costs arising from additional issuance of long-term liabilities

Depending on the level of TLAC requirement, funding in the form of long-term liabilities which are not necessary for asset-liability management (ALM) purposes would be forced, resulting in an increase in funding costs.

(3) Costs incurred for funding in non-home markets

In the case where funding is made through non-home markets due to the immatureness of the home market, costs related to the establishment of disclosure framework and continuous marketing and investor relations activities will occur. Further, preliminary funding costs to address exchange rate fluctuations and home country bias at the time of financial crisis will also occur.

(4) Aggravated balance between demand and supply of TLAC-eligible instruments

In the case where a large volume of TLAC-eligible instruments need to be issued in a short period of time because a sufficient period is not set to implement the requirements, balance between demand and supply in the markets would aggravate, resulting in an increase in funding costs.

(5) Administrative costs

Administrative costs required for restructuring to meet TLAC eligibility criteria, including changes in corporate structure and in an issuer of liabilities, will occur.

Question 16 What will be the impact on the financial system and its ability to provide financing to the real economy?

The impact on financial system and real economy vary depending on the TLAC requirement and eligible liability criteria. Nonetheless, an increase in lending rates due to a rise in funding costs, and a decrease in lending activities for purposes of reducing RWAs might occur. In particular, an impact on G-SIBs that have ample deposits and place lower importance on financing from bonds market may be larger. If bond issuance by G-SIBs increases to address TLAC, it is assumed to have an impact on the funding amount and cost of corporates that have been using the bonds markets (a decrease in funding amount available and an increase in funding costs). Such an impact should be analyzed in more detail through in-depth market impact survey, as described in our response to Question 17.

Question 17 Do you have any comments on any other aspects of the proposals?

Market impact survey needs to be carried out in a cautious manner, taking into account the characteristics of capital markets in respective jurisdictions, and future changes in primary market environment.

For purposes of market impact survey, mere comparison of the global market size and estimated issuance amount of TLAC-eligible instruments is considered not sufficient in order to determine the G-SIBs' ability to comply with this regulation. In other words, the characteristics of capital markets in respective jurisdictions, and future changes in primary market environment need to be considered.

Stable issuance of TLAC-eligible instruments in the home market is crucial for G-SIBs. Thus, a detailed survey needs to be carried out for each G-SIB's home market on the potential amount of issuance, profile of potential investors and possible impacts including occurrence of social cost., Specifically, investor class for both primary and secondary markets of respective jurisdictions needs to be identified to be included into the survey. If investors in the capital market of a jurisdiction in which major investors are non-GSIBs financial institutions and corporate entities are not covered in the survey, the result of the survey would not reflect the actual situation. As investor class in capital markets vary across jurisdictions, investors subject to the survey could not be identified in a globally uniformed manner. Hence, interviews with securities firms and brokerages acting as an intermediary between issuers and investors need to be conducted prior to the survey in order to identify investors to be covered by the survey.

With regard to future changes in primary market environment, impact from the implementation of various global financial regulations need to be considered. Such changes include behavioral changes in investors associated with aggravation in investment demand as a result of implementing the framework for controlling large exposures and reviewing RWAs of the standardized approaches, and increased needs of funding through senior bonds impacted by the implementation of the liquidity requirements. Another factor that may change primary market environment is the review of ratings by rating agencies. Unless these factors are considered, impacts that the implementation of the TLAC regulation may have on markets would not be able to be identified appropriately.