Ref: CHG/22/R2
September 30, 2020

Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel, Switzerland

Japanese Bankers Association

JBA Comments on the FSB Consultation Report: "*Evaluation of the effects of too-big-to-fail reforms*"

Dear Sir / Madam

The Japanese Bankers Association[1] (the "JBA") appreciates the opportunity to comment on the Financial Stability Board's ("FSB") consultation report on the *Evaluation of the effects of too-big-to-fail reforms* ("the Consultation report"), released on June 28, 2020.

Concerning the "too-big-to-fail reforms" and resolution issues, the JBA submitted our comment letters on June 19, 2019[2], and on August 2, 2019[3]. The JBA supports the work by the FSB to address the too-big-to-fail (TBTF) issues. However, the JBA believes that the following points should be carefully considered before finalization.

1. Necessity of further evaluation

In relation to market fragmentation, the FSB report on market fragmentation[4] explained as below.

"*Market fragmentation as part of the evaluation of reforms. To enhance the understanding of authorities of the potential effects of post-crisis reforms, potential fragmentary effects would be incorporated in the FSB's work on evaluation of the effects of reforms. Concretely, the FSB evaluation of the effects of TBTF reforms would consider, as part of its analysis of the broader effects of those reforms, whether any of these reforms have affected market fragmentation with observed consequences for financial stability.*"

In addition, the Termes of Reference of the evaluation[5] explained as below.

"*The analysis of G-SIBs will include assessments of both domestic and cross-border effects, including possible implications for host financial systems in FSB and (where possible) other jurisdictions. The analysis of D-SIBs will include assessments of TBTF policies in FSB jurisdictions consistent with the SIFI Framework. These analyses will also examine the interactions and possible spillovers (including in terms of interconnectedness) of TBTF policies on other sectors – insurance and central counterparties – while recognising that implementation is not far enough advanced to assess the reforms targeting these sectors.*"

We understand that the mandate granted by the FSB report to the FSB's work on the evaluation is to measure the potential effects of market fragmentation within the TBTF framework and is not limited to internal Total Loss-Absorbing Capacity ("TLAC"). In practice, there are various costs, such as Foreign Banking Organizations regulations (requiring an IHC to be established) in the United States, the Intermediate Parent Undertaking requirement in Europe, and preparation of recovery and resolution plans in each jurisdiction.

These regulations may impede the optimization of capital and liquidity allocation within each financial group and may also impede the proper functioning of the internal TLAC, as designed by the FSB. Moreover, they may adversely affect resilience and resolvability of SIBs as a whole. We understand that it is difficult to quantify these impact, but it would be premature, at least without an in-depth analysis on them, to conclude that TBTF reform has been

[1] The Japanese Bankers Association is the leading trade association for banks, bank holding companies and bankers associations in Japan. As of September 30, 2020, the JBA has 117 Full Members (banks), 3 Bank Holding Company Members (bank holding companies), 72 Associate Members (banks & bank holding company), 58 Special Members (regionally-based bankers associations) and one Sub-Associate Member for a total of 251 members.
[2] https://www.zenginkyo.or.jp/fileadmin/res/abstract/opinion/opinion310641.pdf
[3] https://www.zenginkyo.or.jp/fileadmin/res/abstract/opinion/opinion310802.pdf
[4] https://www.fsb.org/wp-content/uploads/P040619-2.pdf
[5] https://www.fsb.org/wp-content/uploads/P230519.pdf

progressing as intended.

Moreover, the report concluded that a decline in lending as one of social costs in the analysis. While G-SIBs have reduced their domestic credit relative to GDP, other banks and financial institutions (mainly non-bank financial intermediaries (NBFI), as the report indicated) have "picked up the slack" and the supply of credit has not been materially affected, therefore the report reached the conclusion that the "TBTF reforms bring net benefits to society" (Page4) and "there is no evidence that TBTF reforms have negatively affected loan volumes" (Page49).

But currently NBFIs are not under the prudential regulations which are applicable to SIBs and credit risks have shifted from regulated banking system to unregulated one.

The FSB has a plan to assess the potential vulnerabilities related to non-bank financial sector and to develop policy recommendations designed to address related financial stability risks. This might decrease NBFIs' activity in lending market and it might lead to the decline in the total lending. We believe that the FSB can arrive at final conclusion regarding the cost-benefit analysis only after such vulnerabilities assessment.

In summary, we are of the view that the evaluation should be continued going forward.

2. Cross-border coordination and cooperation

As noted in the Consultation report, cross-border coordination and cooperation are one of outstanding challenges. We can find some host regulations which go beyond international agreements and focus on financial soundness and resolvability solely in the host jurisdictions. They may undermine the resilience of a bank as a whole and limit the ability of banks to absorb external shocks across different jurisdictions.

In addition, while a home country's group-wide resolution plan based on the Single Point of Entry strategy exists and internal TLAC is allocated to SIBs' material subsidiaries in the host jurisdictions, some FSB member jurisdictions require banks to develop "local & stand-alone" resolution plan in their jurisdictions. SIBs usually need to prepare a number of recovery and resolution plans, which have to be updated on a regular basis, but timing is not aligned. Such burden makes it difficult for SIBs to focus on the remaining gap to make themselves fully resolvable.

We are of the view that this happens because host authorities don't give full trust to the efforts of home resolution authority and there is an opportunity to improve. The home authority and the CMG members need to collaborate on resolution planning further to ensure there is an alignment and agree to a group-wide resolution plan that covers all material subsidiaries and resource allocations (including internal TLAC). We believe that information sharing regarding resolution framework and strategy of each jurisdiction would contribute to build trust among authorities and avoid fragmentary actions.

3. Complexity analysis from multiple angles

We believe that complexity should be analyzed from multiple angles by complementing quantitative analysis with anecdotal evidence. As noted in the Consultation report, the number of subsidiaries is one of factors that influence corporate complexity, but the increase in the number of subsidiaries is a result from responding to the regulations in each jurisdiction such as described in section 1 of this letter (e.g. US IHC, EU IPU) and other aspects can also add complexity to SIBs.

We believe the ownership structure and the alignment with the resolution plan is more important than the number of subsidiaries in terms of judging the complexity, because the chance of an orderly resolution is significantly higher if the corporate structure is coherent with the resolution plan. It is difficult to measure quantitatively whether the structure is aligned with the resolution plan or not, therefore it would be a supervisory judgement.

Complexity can be an obstacle to resolution, therefore it should be addressed. SIBs have been trying to remove it by identifying key legal entities, core functions, critical functions, critical shared service providers, intragroup interconnectedness to enhance their resolvability. SIBs made significant progress over the past decade.

In order to remove complexity more and boost the effects of TBTF reforms and SIBs' effort, we suggest (1) public

information disclosure regarding resolution framework and strategy of each jurisdictions by the resolution authority (NOT firm-specific information such as resolution plan of each SIBs), and (2) clarification on interaction between home country's group-wide resolution plan and hosts' resolution plans by the resolution authorities.

These two would facilitate SIBs' understanding on how resolution plans will work and make them more efficient in resolvability enhancement. In addition, they would be beneficial to improve perception of the credibility of reforms from market participants, credit rating agencies. This could enhance effects of the reforms.

4. Careful consideration on disclosure of firm-specific information

As mentioned in section 3 of this letter, public information disclosure regarding resolution framework and strategy of each jurisdictions (NOT firm-specific information such as resolution plan of each SIBs) is critical to enhance the understanding of resolution framework by the stakeholders (e.g. credit rating agencies, investors).

On the other hand, the disclosure of detailed resolution plan and resolution measures of each SIBs may unnecessarily cause market unrest and may have unintended consequences, such as a decline in the value of certain operations for which continuity is not guaranteed. Taking this into account, it is difficult for individual banks to provide details of their resolution plans (unless those plans are prepared by banks). In addition, firm-specific information disclosure of resolution plan and elements of resolvability enhancement runs the risk of restricting resolution tools in stress and may end up in disclosing sensitive information to the public. We urge the FSB to carefully consider the risks associated with disclosure of firm-specific resolution plan related information.

As with our comments on the FSB's Discussion Paper on "Public Disclosures on Resolution Planning and Resolvability" in August 2019, the extent of disclosure for resolution planning and resolvability and its update frequency should be proportionate to the complexity and systemic importance of respective G-SIB, and "constructive ambiguity" should be purposely left in light of moral hazard risk, which might be adversely promoted among the market participants that may be immune losses in resolution due to ranking higher than those investors who are subject to write-off or equity conversion of external/internal TLAC.

We believe that it would be useful for authorities to first explain the resolution framework and the preferred strategies so that stakeholders fully understand the consequences of the resolution of SIBs.

5. How to assess and capture moral hazard risk

In the Consultation report, in order to examine moral hazard risk reduction, the FSB estimates implicit funding subsidy (state support) by using indicators such as (1) funding cost advantage of SIBs, (2) CDS of holding company and operating subsidiary and (3) credit ratings by agencies.

We agree that these indicators give us useful indications, but they only show how market participants and credit rating agencies evaluate the reforms and don't reflect SIBs' strategies.

The true meaning of moral hazard is SIBs' expectation that they would be able to receive the state support in case of emergency leads to excessive risk-taking, and what the report needs to analyze is whether SIBs have already dismissed such expectation. Therefore, it is better for the working group to complement current analysis by adding another angle. For example, assessment regarding changes in risk appetite of SIBs might be a good approach to complement the quantitative analysis.

After the outbreak of the COVID-19 pandemic, banks have acted as shock absorber and have supported the real economy sometimes beyond the risk appetite in response to the societal demand. This actual example shows that we cannot assess moral hazard risk simply by increase of RWA and that it is difficult to capture moral hazard risk in a single way because appropriate approach depends on the situation.

We believe moral hazard risks need to be redefined in the context of the COVID-19 pandemic, and therefore, the final report should clearly indicate what banks are encouraged to do in the current environment, and that the TBTF framework (e.g. G-SIB scoring) may not be appropriate to apply until the pandemic is over and the market returns to normal.

(End)