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Comments on *Evaluation of too-big-to-fail reforms*

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on *Evaluation of too-big-to-fail reforms,* released by the Financial Stability Board ("FSB") on May 23, 2019.

Our views on effectiveness and efficiency of too-big-to-fail ("TBTF") reforms

We welcome the FSB's initiatives on "Evaluation of too-big-to-fail reforms." Key reforms have already been implemented in major FSB member jurisdictions over the past decade since the recent financial crisis. Evaluating the effects of TBTF reforms is a crucial process for identifying unintended consequences of the reforms and making appropriate adjustments as needed.

We support the commitments and initiatives by G20/FSB to address TBTF. We are of the view that the internationally-agreed TBTF reforms are designed as a regulatory framework that is sufficiently functional, without imposing any unwarranted additional requirements in the host jurisdictions, in reducing potential moral hazard risks and systemic risks posed by the failure of G-SIBs through international cooperation among home and host authorities.[1]

However, the requirements for G-SIBs in fact include not only the internationally-agreed TBTF reforms but also requirements imposed by the host authorities, which may conflict with the TBTF reforms both in terms of effectiveness and efficiency. The ultimate goal – ensuring G-SIBs are resolvable in an orderly manner without posing systemic risk – can be undermined by those host regulations.[2] Therefore, when evaluating the effects of TBTF reforms, it is crucial to assess the effects of the

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[1] G-SIBs are required 1) to hold higher capital buffer (G-SIBs capital buffer) to reduce the likelihood of their failures depending on their risk posed to the global financial system and 2) to meet Total Loss-Absorbing Capacity (TLAC) requirement for their orderly resolution. They are also working on improving their resolvability to eliminate impediments, and report their efforts to the Crisis Management Group (CMG) including the relevant authorities from the home and all key host jurisdictions.

[2] FSB Report on Market Fragmentation, 4. June 2019. https://www.fsb.org/wp-content/uploads/P040619-2.pdf

reforms as a whole, including those carried out by the host authorities.[3]

In particular, we believe that the following issues should be carefully considered both in terms of effectiveness and efficiency in the evaluation of TBTF reforms, as the compound effects of TBTF reforms and host regulations may adversely affect the cross-border regulatory and supervisory cooperation.

- *Market fragmentation arising from host regulations that focus on financial soundness and resolvability solely in the host jurisdictions:* The Federal Reserve Board is now requesting comment on whether the branches of Foreign Banking Organizations ("FBOs") in the U.S. be subject to LCR requirements. EU regulators are also currently finalizing the Intermediate Parent Undertaking ("IPU") requirement as a part of the CRD IV revision. Those rules intend to enhance financial soundness and resolvability of G-SIB's entities solely in the host jurisdiction, and are typical cases of "*jurisdictional ring-fencing*" that trap banks' capital and liquidity in the host jurisdictions. Imposing such host regulations, despite the fact that G-SIBs' capital and liquidity are well managed and sufficiently meet prudential requirements at the global level, could lead to undue burdens to the G-SIBs and inflexibility of capital and liquidity. From the perspective of financial stability, this may also undermine the resilience of a bank as a whole, and may also limit the ability of banks to deal with external shocks across different jurisdictions, particularly in times of stress and resolution.

- *Lack of effective framework to promote cooperation between home and host authorities:* While a home country's group-wide resolution plan exist and internal Total Loss-Absorbing Capacity ("TLAC") is allocated to G-SIBs' material subsidiaries in the host jurisdictions, some FSB member jurisdictions require banks to develop an additional resolution plan in their jurisdictions. Considering these facts, we are of the view that the FSB's cross-border framework to operationalize home and host authorities' cooperation is not yet sufficient. Currently, the interaction between home country's group-wide resolution plan and hosts' resolution plans, as well as the communications among the home and host authorities in resolution are kept in a black-box, or at least are not disclosed to the G-SIBs. Consequently, G-SIBs cannot recognize how resolution plans will work and what communication will be made among the authorities during the resolution

[3] *Evaluation of TBTF Reforms Summary Terms of Reference* issued by the FSB states that "[o]ther national/regional regulations that fall outside the scope of G20 reforms will only be covered to the extent they are relevant for assessing the effects of G20 TBTF policies in particular FSB jurisdictions."

process, and hence it may be difficult for G-SIBs to take appropriate actions in the event of resolution. We are seriously concerned that this may impede the effective resolution in an orderly manner.

Our suggestions on the evaluation process for TBTF reforms and next steps

We respectfully suggest the following points to be addressed for the evaluation of TBTF reforms and potential next steps based on the results:

- *Evaluating TBTF reforms from viewpoints of both effects and efficiency:* We believe that the key viewpoints in evaluating TBTF reforms are to examine not only the effects but also the efficiency of regulations, as Mr. Randal K. Quarles, FSB Chair, pointed out.[4] As discussed above, an appropriate evaluation from perspectives of both effectiveness and efficiency of TBTF reforms should include host regulations that may conflict with internationally-agreed TBTF reforms. We believe that some tangible issues have already emerged in this area. Unduly complex or fragmentary regulations across jurisdictions should be optimized without compromising on the objectives of the reforms. We respectfully ask that the FSB tackle such imminent issues by prioritizing optimization in their evaluations.

- *Complementing quantitative evaluation using qualitative information:* While key reforms have already been implemented in major FSB member jurisdictions, the true effects of TBTF reforms need to be evaluated continuously over a longer term, including through crises and credit cycles. In addition, market and macroeconomic data may be susceptible to individual economic, financial and market structures and characteristics of each jurisdiction as well as various external factors. Therefore, we believe that it is not appropriate to evaluate the effects of TBTF reforms in respective jurisdictions by only using the same set of specific indicators worldwide. Moreover, when interpreting the results of quantitative and empirical analyses, greater importance should be given to complementing quantitative evaluation using qualitative information, such as the characteristics of the jurisdiction's economy and the financial markets, as well as the individual bank's business model and risk profile. For example, commercial

[4] "Many of the reforms have been in place long enough for them to be evaluated. We can judge whether reforms are having their intended effects and making the financial system more resilient. Are any regulatory reforms causing unintended, adverse effects? Can we achieve the same, strong level of financial resilience with reforms that are more efficient, simple, transparent, and tailored? The FSB must champion efficient and effective regulation in order to maintain public support for the progress we have made". https://www.bis.org/review/r190328b.htm

banking business based on long-term relationships with clients consist a large proportion of Japanese banks' business, hence making them relatively more stable.

- *Fair evaluation of the systemic risk reduction effects of TBTF Reforms:* While TBTF reforms aim to reduce the systemic risk posed by failure of individual G-SIBs, systemic risks posed by other factors are addressed by enhancing the resilience of the financial system as a whole by strengthening capital and liquidity of banks under Basel III. The ultimate goal of reducing systemic risk through TBTF reforms is to ensure that the G-SIBs are resolvable in an orderly manner without creating systemic disruption. We are of the view that this has basically been assessed through a review of resolution plans and resolvability assessments through the Crisis Management Group ("CMG"). Therefore, the results of this review should be taken into account in evaluating the systemic risk reduction effects of TBTF reforms. Moreover, systemic risks can also be addressed using various policy tools available in each jurisdiction, which are not only orderly resolution of G-SIBs, but also, for example, powers granted to authorities under the resolution regime in each jurisdiction as well as monetary easing measure or liquidity provision by central banks to markets. One of the objectives of TBTF reforms is to ensure that the orderly resolution of G-SIBs is a feasible and operational option for the resolution authorities. TBTF reforms should not be regarded as an universal tool to address all types of systemic risk.

- *Evaluation of coordination among home and host authorities:* The progress of coordination among home and host authorities should be included in FSB's evaluation of the effects of TBTF reforms. We understand that the FSB has repeatedly emphasized the importance of coordination among the home and host authorities in achieving orderly resolution. Nonetheless, we are of the view that trust among authorities is still not sufficient, hence giving rise to increased fragmentary regulations at the host jurisdiction level that go beyond international agreements. In order to end TBTF, we believe that it is crucial to promote coordination among authorities for ensuring resolution plans operationalize and promote transparency through appropriate disclosure of discussions among the authorities. The FSB should promote those coordination among the authorities, and one of the potential solutions to achieve it would be to, for example:

  - Discuss and agree at the CMG on how home and host authorities will communicate with each other and how to absorb losses and recapitalize G-SIBs in resolution, in order to make resolution plans more feasible and operational.

- *Balancing regulation and supervision:* The balance between regulation and supervision should be carefully taken into account for future consideration on any potential policy recommendations based on the result of evaluation of TBTF reforms. Core supervisory tools have already been put in place in the context of addressing TBTF, such as home country's group-wide recovery and resolution planning, as well as CMGs in which the home and host authorities discuss firm-specific resolution strategy and resolvability assessment. We believe that leveraging and deepening such supervisory framework among home and host authorities is the most effective and appropriate way to ensure resolvability of G-SIBs and to optimize unduly complex and fragmentary regulations across jurisdictions. Any challenges associated with the supervisory framework among the home and host authorities should not be addressed by introducing additional regulations for G-SIBs.

(End)