Ref: KIG/43/2022
April 8, 2022

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

Japanese Bankers Association

JBA comments on the FSB Discussion Paper "*Approaches to Debt Overhang Issues of Non-financial Corporates*"

Dear Sir / Madam:

The Japanese Bankers Association[1] (JBA) appreciates the opportunity to provide our comments on the Financial Stability Board's Discussion Paper "*Approaches to Debt Overhang Issues of Non-financial Corporates*" (the Discussion Paper) released on February 22, 2022.

General Comments

Since the pandemic began, banks have been taking risks by providing funds to the real economy as part of our societal role. Unlike the Global Financial Crisis, we have been functioning as a source of strength to our economy, not source of risk. There is no doubt that one of the reasons why we have been able to do this is the government support measures such as the guarantee framework or special treatment in the risk weight calculation, as well as large-scale liquidity provision measures from central banks. This serves as a good example of successful cooperation between the public and private sectors. On the other hand, the public support measures or bank lending will not last forever and must end at some point for things to go back to normal again. In the case when non-financial institutions' debt exceed their solvency, how these issues will be addressed is one of our key challenges, both from banks' strategy perspective and from a social function perspective. We believe it is appropriate that the FSB, as an international standard setter whose assignment is ensuring the financial stability, is taking the lead in this discussion.

An important point to note is that there should be no winners or losers in this discussion. This is a result of unforeseen external circumstances and no one should be punished. Although, in the Discussion Paper it is stated as "ever-greening" that banks continue refinancing to insolvent firms, we would like to point out that banks do not automatically continue refinancing nor decide refinancing just because banks "do not want to recognize loss". The loans are determined after assessing carefully and independently the firm's credit situation and viability, which is the most important part of banks' normal process. More than two years have passed since the pandemic began, and we need to identify corporates that lost their resiliency "only because of the pandemic" and corporates which have fundamental prudential concern, "regardless of the pandemic." Banks should monitor carefully the situation, and for the latter corporates, there would be the case we should proceed to restructuring or exits. In those cases, it would be true the credit risk be increased. However, this is simply due to banks' credit assessment and could be seen as things have returned to normal. Excessive risk-taking by banks will lead to instability of the financial system, which is the lesson learnt from the GFC. On the contrary, a sound financial system is critical to addressing debt overhang issues. We need to return to normal so that the crisis response will not bring about another crisis.

[1] The Japanese Bankers Association is the leading trade association for banks, bank holding companies and bankers associations in Japan. As of January 20, 2022, JBA has 114 Full Members (banks), 3 Bank Holding Company Members (bank holding companies), 77 Associate Members (banks & bank holding companies), 58 Special Members (regionally-based bankers associations) and one Sub-Associate Member for a total of 252 members.

Dealing with a large number of companies with debt restructuring needs - Supporting SMEs as banks' social role

When banks try to deal with debt restructurings/ refinancings, there are no "one-size fits all" solutions, same as there are no "one-size-fits-all" issues. The situation differs by corporates, and same methods cannot be used. Large, listed firms tend to have many avenues to achieve financing, through not only bank lending but also the financial market or equity finance, and are relatively sound enough to take path to recovery by themselves. Compared with them, as the Discussion Paper stated, it is an unfortunate fact that the micro enterprises and natural persons tend to face more difficulties when they try to recover. Lack of resources may challenge SMEs' abilities to pursue a restructuring procedure. In general, this means SMEs need more support than large firms. Recently in Japan, a new out-of-court workouts (OCW) guideline for SMEs has been compiled under the initiative of the private sector in working with the authorities. This guideline reiterated the roles of both financial institutions and SMEs, and provides new OCW procedures for SMEs. Over 95% of Japanese firms are classified as unlisted, mid-scale SMEs and it is the social role for Japanese banks to support these SMEs.

As the Discussion Paper says, where a high number of viability assessments, possibly of SMEs, have to be performed in a short time, banks may seek to develop structured approaches to facilitate a swifter path to the application of restructuring tools to corresponding restructuring needs. One of the possible and an effective start to this approach is identifying which sectors have suffered permanently/structurally. During the COVID-19 pandemic, some sectors such as aviation, hospitality, or food services are significantly damaged. Banks should assess these sectors carefully, and at the same time we should pay due attention to each corporate. We should undertake both a sector-wide and corporate-specific approach.

Restructurings and government support end

There is no doubt that governments play important roles for supporting corporates. The roles become more important when it comes to highly-leveraged corporates. However, as the Discussion Paper says, while sometimes restrictions are placed on public creditors accepting haircuts or initiation of restructuring, rather, the governments provide the corporate support using the tax system and social security claims.

During the COVID-19 pandemic, unexpected levels (both direct and indirect) of government support measures have been implemented. As government supports phase out, a certain number of debt restructuring would be required, and it will likely result in increases in credit risk. However, this is a matter of course in terms of pure bank credit and viability assessments, and considering the market mechanism, this would be one of the processes of "return to normal".

Having said this, when banks determine whether a firm will be restructured or not, what should be secured is discipline and integrity. This is the responsibility of banks as a creditor, and as one of the market participants. Also, we would like to ask governments to gradually end government supports, so as to avoid a cliff-edge effect.

Global discussion and Local practice

One of the unique aspects of this "debt-overhang" issue is that, regardless of the corporate size, "localized" approaches will be required. To deal with this issue, whether a firm will be able to recover or be advised to exit, a customized pathway based on close and deep communication between banks and firms are required, in accordance with the jurisdiction's circumstances.

In addition, close communication with regional authorities, legal entities, or even with other banks is also necessary. We should also work together with private banks so as not to result in a cliff effect when support measurements are ended.

In this context, we suppose the main role of the FSB and other standard-setting bodies is to respect and monitor the localized initiatives in each region and share the best practices. In cases where any supervisory expectations would be required, the expectations should be kept at a high-level and not set any standards or requirements to limit these localized public-private initiatives.

We hope the FSB finds our comments useful.

(End)