

October 10, 2014

Comments on the Basel Committee on Banking Supervision's Consultative Document
"Review of the Pillar 3 Disclosure Requirements"

Japanese Bankers Association

We, the Japanese Bankers Association, would like to express our gratitude for this opportunity to comment on the consultative document *"Review of the Pillar 3 Disclosure Requirements"* released on June 24, 2014 by the Basel Committee on Banking Supervision (the "BCBS").

We hope that our comments below will be of assistance and offer an additional point of reference as you work towards finalising the framework.

General Comments

1. The implementation date should be set in 2018. (Paragraph 8)

The Consultative Document proposes that the public disclosure requirements should take effect by no later than 1 April 2016. Meanwhile, many regulatory reforms are scheduled to be implemented by 2017, including the leverage ratio disclosure requirements, the SA-CCR (the standardised approach for counterparty credit risk) and the revised capital requirements for banks' investments in funds.

Given the necessity and significance of the development of information systems and internal controls to implement those regulations, banks would need a reasonable lead time to satisfy the Pillar 3 disclosure requirements. Therefore, it is requested that the timing for implementation be deferred to the year 2018.

2. The requirement regarding the timing of publication of Pillar 3 reports should be relaxed. (Paragraph 22)

The Consultative Document requires banks to "publish their Pillar 3 reports concurrently with their financial reporting when the two reporting dates align". The Committee is requested to relax this requirement to allow the publication of Pillar 3 reports after financial reporting, or to provide a transition period so that banks are permitted not to comply with the requirement concurrently with the initial application of the Pillar 3 disclosure requirements.

While we are fully aware of the importance of providing risk-based information to the market as soon as possible, the above request is made because it is difficult to satisfy

the required timing unless at least a certain period of time is given for banks to make necessary preparations. In practice, risk metrics are not calculated until accounting information is finalized in order to ensure consistency of them and also due to resource constraints. Additionally, management needs time to make an analysis of such information. Therefore, in practice, a time lag exists between the reporting of financial and risk information. Requiring concurrent reporting of these two sets of information could affect the process of preparing accounting information, based on which risk metrics are calculated, as well as its accuracy.

3. To facilitate understanding by and enhance meaningfulness for depositors and general investors, it is requested to clarify the “principle of materiality” in respect of the disclosure granularity and the reporting frequency. (Paragraphs 24, 37, etc.)

The Consultative Document proposes an increased number of disclosure items compared to the current Pillar 3 framework, as well as reporting on a quarterly basis. However, a considerable volume of disclosures could make it difficult to identify which information is significant. It could make it difficult particularly for some non-professional market participants, such as depositors and general investors, to understand disclosed information and could also make such information meaningless for users.

In accordance with the Principle 3 (i.e. disclosure should be meaningful to users), paragraph 37 requires banks to highlight their “most significant” risk information. However, it does not provide specific guidance as to what is a “meaningful” disclosure. Therefore, it is recommended that quantitative criteria will be set to clarify the “principle of materiality”, and those exposures whose amount is immaterial and which are also considered to be insignificant in the context of risk management will be excluded from the disclosure requirements. This should enable depositors and general investors to identify significant information more easily and facilitate their understanding of and enhance the meaningfulness of Pillar 3 disclosure. (We would like to comment in details on individual templates for which such quantitative criteria should be set, in the following “Specific Comments” section.)

Specific Comments

1. Disclosure of hypothetical standardised approach (SA) capital by banks using internal ratings-based approaches (IRB) should be discussed carefully. (Paragraph 13)

The Consultative Document stipulates that “as part of the second phase, the Committee also intends to consider the possibility of requiring banks using internal ratings-based approaches for credit risk to disclose hypothetical capital requirements according to the standardised approach for credit risk”.

Banks using the IRB manage their credit risk in line with the IRB framework based on their own internal data. Requiring them to disclose SA-based capital requirements, which are not required to be calculated under the Pillar 1 framework nor are used for internal management purposes, means to impose calculation and disclosure of metrics that differ from what they apply in their actual credit risk management practices. Therefore, it is not considered to be appropriate.

The SA-based calculation is less granular and has lower risk sensitivity than the IRB-based calculation. Given this, it is not reasonable to explain the difference of the portfolio’s risk characteristics or models between banks by using the difference of the calculation results between the IRB and the SA.

Further, there is concern that setting the SA as a benchmark may give misleading information to users that the SA-based calculation produces more accurate or reliable results. This, in the result, undermines the effectiveness of the IRB framework, which may disincentivize financial institutions to enhance their risk management and may aggravate the level of risk management practices of the overall banking industry.

Given the above and present conditions, there is not much significance for banks using the IRB to invest in human resources and systems in order to disclose the SA-based capital. To our understanding, the Committee is currently discussing the proposed treatment to set more risk-sensitive SA as the floor for risk-based capital. The Committee is requested to defer reaching the conclusion on whether to require the disclosure of hypothetical SA capital in the Pillar 3 framework until the completion of that discussion.

It is also requested to delete, from the final rule, the description regarding the disclosure of hypothetical SA capital by banks using the IRB, even if it only suggests the possibility; because such a description may give misleading information to related parties, including investors and depositors, that the Committee has already made a final decision on the implementation of such disclosure.

2. Descriptions regarding templates/tables with a flexible format, i.e. “(or greater than)” and “ie at least the same level of granularity as if the template/table were completed”, should be replaced with “to the extent that the information is meaningful”. (Paragraphs 42 and 43)

Banks are allowed to delete a row/column from the templates with a fixed format (paragraph 42) if it is considered not to be applicable. On the other hand, when the format of a template/table is flexible (paragraph 43), banks are allowed to customise the format but are required to “provide information equivalent to (or greater than) that required in the disclosure requirement”. This can, in substance, be construed as a minimum disclosure requirement, undermining the flexibility of the flexible format which should allow preparers to make decisions on which information to present in accordance with the level of significance and should pursue easier understanding for users.

Given this, consistent with the Guiding Principle 3 (i.e. disclosure should be meaningful to users), it is requested that the Committee should delete the two descriptions “(or greater than)” and “ie at least the same level of granularity as if the template/table were completed” from paragraph 43 and add the description “to the extent that the information is meaningful” at the end of the paragraph.

3. Comments on Templates/Tables

| Template/Table | Comment |
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| Template LI1 | <p>Since exposures used for the calculation of capital requirements only arise from assets, and given the principle of materiality, the column for liabilities is considered to be unnecessary and thus should be deleted.</p> |
| Template CR3 | <p>Although the note in page 19 (“Linkage across templates”) specifies, in the form of a formula, that the sum of CR3 exposures equals the amount of CR1’s “Net Value”, they are not equal.</p> <p>It is because the amount of CR3 exposures to be presented do not reflect provisions and write offs whereas such provisions and write offs are deducted from the amount of CR1’s “Net Value”.</p> <p>To address this point, the following amendment is proposed.</p> <p>[Proposed amendment]</p> <p>Insert the following sentence after the formulas set out in the note “Linkages across templates”:</p> <p>These linkages are applicable in SA, since in IRB the amounts in CR3 are measured gross of specific provisions or partial write-offs as stipulated in paragraph 308 of Basel Accord.</p> |
| Templates CR7 and CR10 | <p>It is requested that the frequency of disclosures related to credit risk mitigation techniques be changed from the proposed quarterly basis to “as frequently as financial reporting”.</p> <p>There are two reasons. First, metrics related to the credit risk mitigation techniques are not expected to change rapidly over such a period as 3 months. Second, given the purpose of a quarterly disclosure, which is to provide key information related to capital requirements calculations, the volume of quarterly disclosures in the proposed Pillar 3 framework is rather excessive. Of the proposed disclosures, the materiality of this information is considered to be relatively low.</p> |
| Templates CR7 and CCR3 | <p>From the perspective of providing genuinely meaningful information to users, SA-based disclosure should be needed only to those banks exceeding certain quantitative criteria. Thus, the committee is requested, based on the principle of materiality, to note in the explanation of these templates that those banks applying the SA only to a minimal portion of their portfolios (e.g. the percentage of the RWA of the SA-based assets to all assets is below the threshold (1%) and thus is immaterial) are to be exempted from the SA-based disclosure provided that they describe such a fact. Assuming a financial</p> |

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| | <p>institution with 8% capital adequacy ratio, a 1% change in the total amount of RWA will give less than a 0.1% impact on the capital adequacy ratio. Given this, a threshold of 1% is deemed to be an adequately-low quantitative criterion.</p> |
| <p>Template CR11</p> | <p>The description in parenthesis should be deleted from the following sentence: “Format:Flexible (provided the content and the granularity are at least equivalent)”. Or, disclosure should be limited to those drivers of changes exceeding certain quantitative criteria (e.g. the percentage of the amount of changes in the total RWA exceeds the threshold (1%)).</p> <p>If the proposed template is used, all banks will be required to disclose movements in RWA by distinguishing at least those drivers of changes set forth in No. 2 to 7 in the template. However, it is difficult to distinguish drivers of changes to RWA in such a uniform manner because they differ across banks depending on business models and risk profiles; and further, such drivers of changes are interrelated. Taking this into account, combined with the principle of materiality, it would be preferable to allow banks to determine which drivers of changes should be disclosed to the extent reasonable, instead of requiring them to present all prescribed drivers of changes in every reporting.</p> <p>Assuming a financial institution with an 8% capital adequacy ratio, a 1% change in the total amount of RWA will give less than a 0.1% impact on the capital adequacy ratio. Given this, a threshold of 1% is deemed to be an adequately-low quantitative criterion.</p> |
| <p>Template CR12 (Interpretation of “the granularity are at least equivalent”)</p> | <p>With regard to the description “Format:Flexible (provided the content and the granularity are at least equivalent).”, it is requested that the Committee allows banks to disclose this information at the combined portfolio level in some cases. Such cases include where the PD is estimated by combining portfolios for LDPs (Low Default Portfolios) in accordance with the example provided in the Committee’s newsletter (Annex of the Basel Committee Newsletter No.6: “Validation of low-default portfolio in the Basel II framework” issued in September 2005).</p> |
| <p>(Column “External rating equivalent”)</p> | <p>The “External rating equivalent” column is considered as unnecessary. External ratings do not serve as a common measure that enables comparison of PDs across banks because the definition of default and the method to calculate the default rate differs across external rating agencies.</p> |
| <p>(The period of</p> | <p>While a 5-year period is requested to calculate the “Average historical annual</p> |

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| <p>“Average historical annual default rate”)</p> | <p>default rate”, a longer period will produce a “more stable” default rate. Therefore, if an average default rate over more than 5 years is used to estimate the PD, such a period should be deemed as the period of “Average historical annual default rate”.</p> |
| <p>(Disclosure at individual jurisdiction level, separate templates for FIRB and AIRB)</p> | <p>In disclosing the portfolio breakdown at individual jurisdiction level or by separating FIRB and AIRB, it is appropriate to do so in line with risk management practices for the following reasons.</p> <p>For example, in the case where a single rating system is applied to multiple jurisdictions (e.g. U.S. and Japan) and there is only a limited number of samples for a specific jurisdiction (e.g. U.S.) and thus it is difficult to demonstrate the meaningfulness of parameters used solely based on actual results of that jurisdiction, separate disclosure of that jurisdiction may give rise to misunderstanding that parameters deviate from the actual results, even if actual back-testing has not identified any problem. Similar misunderstanding occurs when separating disclosure for FIRB and AIRB.</p> <p>Given the above, the Committee is requested to consider amending the description of “Format” as follows:</p> <p>“... The portfolio breakdown in the rows will be set in aligned with internal risk management (e.g. at an individual jurisdiction level or at a geographical level) to reflect exposure categories...”</p> |
| <p>(Analysis related to “cured” obligors)</p> | <p>Banks are required in “Accompanying narrative” to disclose “the amount of exposure and the number of obligors whose defaulted exposures have been cured in the year”. This requirement should be limited to the case where such cured exposures are reflected in estimating the PD.</p> <p>Some banks treat such cured exposures as recovered and reflect them in calculating the LGD. In such cases, the PD estimate does not link to cured exposures, making the cured exposure information irrelevant to back-testing of PD.</p> <p>In order to enable those banks to use this template, the Committee is requested to consider amending the description of “Accompanying narrative” and also the description contained in template CRE as follows:</p> <p>[Insert the underlined sentence in the “Accompanying narrative” of Template CR12]</p> <p>“Banks must also supplement the template in disclosing the amount of exposure and the number of obligors whose defaulted exposures have been cured in the year, <u>if banks count them for the PD estimation purpose.</u>”</p> |

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| | <p>[Insert the underlined sentence in Template CRE]</p> <p>“f (iv) <u>treatments of cured exposures in the parameter estimation</u>, any deviation from the definition of default as permitted by prudential regulations (where these are determined to be material, banks must also indicate for each class the main categories of exposure affected by such deviations);”</p> |
| Template CCR5 | <p>The effectiveness of coverage of collateral received by banks does not vary depending on whether it is “Segregated” or “Unsegregated”. Further, whether collateral posted by banks is “Segregated” is not relevant to the mitigation of counterparty risk. Therefore, such information does not provide any benefit to investors. Furthermore, the Committee does not require segregation of collateral as a minimum requirement in its related rules (The Basel rules text does not set forth such provisions in paragraph 145 and subsequent paragraphs regarding minimum requirements for collateral). Therefore, disclosure by distinguishing “Segregated” and “Unsegregated” collateral is considered to lack reasonableness. Given the above, to ensure the meaningfulness of information, collateral should be disclosed on a gross basis without classifying it into “Segregated” and “Unsegregated”.</p> |
| Template MR3 (RWA movement by key driver) | <p>Instead of disclosing a full breakdown of the RWA movement, an alternative disclosure approach is recommended. Specifically, only in the event of certain level of material changes, banks will need to disclose key drivers for such changes and the amount of impact caused by such changes so that investors can gain an understanding of the material changes (as shown in the proposed template below).</p> <p>Allowing flexibility for the content of this disclosure; for example, by limiting disclosed information to the extent that satisfies investors’ needs in accordance with the principle of materiality would enable the preparation and submission of this template on a regular basis and in a prompt manner.</p> |

| | VaR | Stressed VaR | IRC | CRM | Total VaR |
|--------------------------------------|-----|--------------|-----|-----|-----------|
| RWA at end of reporting period | xxx | xxx | xxx | xxx | x,xxx |
| RWA at previous reporting period end | yyy | yyy | yyy | yyy | y,yyy |
| Change | zz | zz | z | (z) | zz |

Key drivers of the material changes

(e.g. Movement of market risk, Market movement, Model update/change)

(add narrative comments related to major factors which contributed to material changes to each risk.)

ex.

[Model change] changed VaR/Stressed VaR calculation method to taking into account weighting scheme

Impact to VaR: bb, to Stressed VaR: cc

[Market movement] USD yield curve steepening impacted VaR increase

Impact to VaR: dd