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July 31, 2014

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# Position Paper on Gone-concern Loss Absorbing Capacity (GLAC)

This Paper is intended to provide recommendations from the Japanese Bankers Association[1] with regard to gone-concern loss absorbing capacity ("GLAC") for global systemically important banks (G-SIBs[2]) which are currently being discussed by the Financial Stability Board ("FSB").

We understand that the objective of the FSB's policy recommendations on the TBTF issue and the work toward implementing these recommendations is to avoid reoccurrence of another financial crisis, and highly appreciate the FSB's initiative.

As discussions on GLAC will have a significant impact on activities in international financial markets, we would like to take this opportunity to provide our comments.

We respectfully expect that our recommendations will contribute to your further discussion in determining the final policy.

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[1] The Japanese Bankers Association is a banking industry organization comprised of 191 banks operating in Japan.

[2] As of November 2013, of banks having a head office in Japan, 3 financial groups, Mitsubishi UFJ Financial Group, Inc., Mizuho Financial Group, Inc. and Sumitomo Mitsui Financial Group, Inc., are included in the list of G-SIBs.
(Ref.) http://www.financialstabilityboard.org/publications/r_131111.pdf

## Recommendations

1. **Resolution regime of each jurisdiction should be taken into account in determining the amount of GLAC.**
2. **The amount of GLAC should be in line with resolution strategies that differ by bank.**
3. **GLAC should be consistent with other existing regulatory frameworks (especially the Basel Accord).**
4. **Various resources of funding by banks should be considered in determining the eligibility of GLAC.**
5. **The location of GLAC should not be confined to holding companies in a home country.**

## AMOUNT

### 1. Resolution regime of each jurisdiction should be taken into account in determining the amount of GLAC.

- The Basel 3 capital rule has been developed for building a resilient financial system, covering all financial institutions. The rule sets out a globally consistent standard in terms of a level playing field, since the rule aims for sustainability of financial institutions. On the other hand, GLAC is a gone-concern-based framework that realizes orderly resolution of G-SIBs, maintains G-SIBs' critical functions and avoids the use of taxpayers' money.
- Resolution regimes differ significantly by country and the development of regimes for covering costs associated with resolution also differs. The costs associated with resolution consist of (i) loss absorbing capacity that the bank itself should hold, (ii) deposit guarantee, and (iii) resolution funds. It is obvious that the amount of (i) depends on the development stage of (ii) and (iii), both of which are contributed by the banking industry. When deciding the amount of GLAC, it is imperative to consider the level of development of deposit guarantee schemes and resolution funds.
- Further, the jurisdictional differences in resolution regimes largely are derived from nationality. Since the resolution regimes are built on national consensus in light of historical experiences (for example, financial turmoil in Japan during the 1990s), the resolution regime established in each jurisdiction should be sufficiently respected. Moreover, effectiveness of such resolution regimes should be sufficiently taken into account if the regimes were actually executed in the past.

## 2. The amount of GLAC should be in line with resolution strategies that differ by bank.

- The measures to implement resolution that avoids tax payers' money and maintains the G-SIBs' critical functions should differ depending on structures and business models.
- Therefore, international authorities require each G-SIB to develop an RRP, which is periodically assessed within CMGs. An RRP, with investment of significant resources by public and private sectors, contains a Recovery Plan (RCP) that intends recovery before resolution and a Resolution Plan (RSP) that is based on resolution regimes. An RRP is a keystone for considering costs for resolution, which are costs for loss-absorption and for recapitalization. The amount of GLAC should naturally be determined by bank, in line with resolution strategies that differ by bank.
- With regards to recapitalization after resolution, the size of banks would be smaller due to implementing an RCP before resolution starts. Thus, determining the amount of GLAC based on the G-SIB size before resolution leads to an excess reserve and hampers capital efficiency. GLAC should be sufficient to hold loss-absorbing capacity for banks after resolution. Full recapitalization, requiring G-SIFIs to hold GLAC necessary for recapitalizing banks before resolution, is an excess demand.

- On the above point, there is a criticism that the limited time frame for resolution (resolution weekend) makes it difficult to implement measures such as asset disposals. However, in ordinary cases, financial institutions aren't suddenly put into resolution, therefore there is sufficient time to implement an RCP, which is a basic assumption for an RRP (=RCP+RSP). Denying that assumption is not in line with the basic thought of an RRP.
- Furthermore, there is an idea that during implementation of an RCP, asset disposals should be avoided in order not to impair franchise value. However, from the objective of orderly resolution, the first priority should be the maintenance of critical functions. Minimizing costs associated with resolution and maintaining franchise value should be a totally different argument.

# NATURE

## 3. GLAC should be consistent with other existing regulatory frameworks (especially the Basel Accord).

- Under Basel III, the primary tool is an RWA based capital requirement. GLAC should also be primarily an RWA based framework. The capital adequacy of a post-resolution bank is also ensured using RWA-based capital ratios in accordance with the Basel III. To maintain the consistency with this, GLAC should also be measured on the basis of RWA-based figures.

- The Basel III capital, a going-concern-based capital, recommends holding a higher level of capital during normal periods. Accordingly, banks try to maintain a higher capital ratio than minimum regulatory requirements, which capital efficiency considerations would suggest.
- Also there is an argument that resolution means the capital ratio is zero, thus excess capital (that goes beyond regulatory requirements) should not be counted as GLAC. However, comparing two banks with same amount of debts eligible as GLAC, the bank with excess capital will be less likely to fail than those without excess capital. Therefore, GLAC should be understood by the total amount of debt and capital.
- The argument that excludes excess capital from GLAC is inconsistent with the Basel Accord and impairs banks' incentives to hold higher levels of capital in ordinary situations, which will ultimately hamper banks' stability.

### 4. Various resources of funding by banks should be considered in determining the eligibility of GLAC.

- Not all banks rely on fund-raising through capital markets. Traditional commercial banks depend more on deposits rather than issuing debt securities. In addition, the traditional commercial model is more sound and stable in terms of capital ratio and liquidity requirements.
- We strongly disagree that only some kind of securities with more than 12-month remaining maturities are appropriate for GLAC since it denies commercial banking models. If GLAC were defined as such, investment banks, whose stability was significantly damaged during the recent market-distorting crisis, would face less or no burden, while commercial banks, which were stable during the crisis, would incur unnecessary costs associated with additional fund raising. It should be noted that it would not only be unfair but also might result in distorting the stable funding structure of commercial banks if wholesale funding banks are treated preferably in terms of the GLAC framework.

## LOCATION

### 5. The location of GLAC should not be confined to holding companies in a home country.

- Resolution strategy should not be binary (SPE or MPE) since most suitable resolution methods for banks are set by RSPs depending on characteristics and resolution regimes. Also, we should not accept a framework which favors one or the other in terms of GLAC.
- GLAC does not need to be located in group holding companies if there is a framework that enables the transfer of creditor losses from branches and/or subsidiaries that are systemically important in host countries, to home countries, where a credible orderly

resolution regime is equipped. As mentioned, the resolution regime is the results of people's choices. The location of GLAC in a home country should be regarded adequate if it is in line with the resolution regime in a home country. Banks' resolvability can be assured through RRP assessment within CMGs.

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