March 13, 2019

Comments on the Consultative Document

Revisions to leverage ratio disclosure requirements

Japanese Bankers Association

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on the Consultative Document, *Revisions to leverage ratio disclosure requirements*, published on December 13, 2018 by the Basel Committee on Banking Supervision (BCBS).

We respectfully expect that the following comments will contribute to your further discussion.

<<Our position concerning revisions to Pillar 3 (disclosure) and Pillar 1 (leverage ratio calculation) requirements >>

1. Our Position

We, Japanese banks, strongly support the *Statement on leverage ratio window-dressing behaviour* (the "Statement")[1] published by BCBS in October, 2018 stating that the supervisors in each jurisdiction will first address potential window-dressing concerns through Pillar 2 (supervisory review process) measures. We at the same time believe that this will have a sufficient effect.

We sincerely respect the Statement and understand what BCBS regards as issues. In fact, given the publication of the Statement and supervisory actions taken in response, many of our member banks have reviewed their activities and operations to ensure that their market and financial control divisions and other relevant divisions never engage in any activities and operations that might be misinterpreted as window-dressing behaviour, and have enhanced awareness across their organization. As such, it is notable that the publication of the Statement itself has a high announcement effect and an effect on banks' behaviour to restrain such activities and operations. We therefore appreciate the Statement as being a very effective communication approach to avoid possible additional costs while ensuring the effects expected by authorities.

Such BCBS's approach is compatible with BCBS's recent priority on supervision rather than developing new policies. Currently, in response to the publication of *the Basel III: Finalising post-crisis reforms* in December 2017 and *the Minimum capital*

[1] www.bis.org/publ/bcbs_nl20.htm

requirements for market risk in January 2019, supervisors and banks of each jurisdiction are in the process of preparing for their full, timely and consistent implementation. Further proposing new regulations amid such situations and agreeing them without any convincing and transparent explanations to banks may give rise to uncertainties over financial regulations again, which may adversely affect the financial stability. In addition, the recent diversification of market participants, including FinTech and BigTech service providers, has given rise to cost competition and regulatory un-level playing field in the financial sector. Therefore, there is a growing need to pay more attention to the balance between the financial stability and the costs for regulatory compliance.

As noted above, we, Japanese banks, strongly support the suggestion expressed in the Statement that each jurisdiction first addresses this issue through Pillar 2, and believe that such an approach will have a sufficient effect.

As the Statement was published, we expected that BCBS would monitor the effects of the above-mentioned supervisory actions at least for one year or other appropriate period and then discuss the necessity and rationality of enhancing Pillar 3. Therefore, undertaking public consultation at this moment was a surprising event for Japanese banks. Supervisors should first obtain and analyse data for the review of banks' behaviour through Pillar 2, and if there is an unacceptable level of gap between exposures in the middle of the term and the term-end, supervisors should simply and directly require the bank to correct it. Furthermore, BCBS should also analyse and examine whether such a gap is caused by banks' intentional behaviour, whether the intentional problematic behaviour has been observed to the extent that requires a uniform global counter measure, and whether there are significant risks to the financial system. To our understanding, BCBS generally makes decisions based on evidence, and in fact, private banks have strived to submit evidence to support their comments in various public consultations undertaken to date. If the enhancement to Pillar 3 is implemented uniformly at a global level without evaluating its necessity and appropriateness based on above-mentioned examination or evidence, the transparency and reliability of BCBS's policy-making decisions may be undermined. Moreover, BCBS could be misunderstood as treating Pillar 3 as a simplified alternative to Pillar 2. Japanese banks intend to cooperate in providing data and explaining backgrounds through practical approaches in supervisory dialogues and QIS to further gain authorities' understanding and confidence about Japanese banks' behaviour.

If however there are any jurisdictions that fail to achieve a sufficient outcome through such supervisory actions, BCBS should first consider taking additional actions, including those other than Pillar 2, for those jurisdictions. Moreover, through announcing such an approach, BCBS should further increase national authorities' motivation and encourage banks' earnest efforts in relation to Pillar 2 that are currently being implemented. It is not reasonable to uniformly enhance Pillar 3 globally, including those jurisdictions with no material gap between exposures regarding leverage ratios in the middle of the term and the term-end, jurisdictions where misunderstanding has been solved through QIS and supervisory dialogues, and jurisdictions that have achieved sufficient outcome through Pillar 2. In addition, as discussed below, BCBS should also sufficiently consider the fact that there are differences in information currently available to relevant authorities and markets, depending on whether the jurisdiction includes central bank reserves in liquidity coverage ratio (LCR) requirements and leverage exposures (Please see page 4. (1)(B) and page 5 (3)(A)).

2. Multiple factors causing leverage exposures' gap between those in the middle of the term and the term-end

If there is an unacceptable level of gap between the leverage ratios disclosed in the quarter-end and actual leverage ratios during the period at some banks in some jurisdictions, it means that the regulatory framework fails to capture the true picture of the financial system and would undermine the intended objective and reliability of the leverage ratio regulation. Therefore, we support BCBS's view to regard such a gap as an issue.

However, the leverage ratio, by its nature, is subject to fluctuation attributable to seasonality that can naturally occur due to customers and counterparties' unique behaviour observed at quarter-ends, as well as changes arising from volatilities in market prices. Therefore, differences observed between leverage ratios disclosed in the quarter-end and actual leverage ratios during the period may arise from factors other than window-dressing or factors that are difficult for banks to intentionally control. From the viewpoint of the financial stability and customer needs, differences arising from such factors are difficult to be solved even if supervision or a disclosure framework is enhanced. For example, in order to maintain the financial intermediation function in a stable manner at all times, banks seek to take risk-averse behaviour in preparation for heightened liquidity risks at a particular date in the future. Although this is an appropriate practice to achieve the financial stability, banks' pre-funding carried out for this purpose would increase leverage exposures several months prior to that particular date, resulting in a gap between actual leverage ratios during the period and the leverage ratios disclosed in the quarter-end.

It is important for relevant authorities to understand, through QIS and future supervisory dialogues, and acknowledge such an unavoidable gap to a certain extent.

<<Consideration on window-dressing intention for the three exposure items proposed by BCBS to be subject to the revisions to the Pillar 3 (disclosure) >>

(1) Adjusted gross securities financial transaction (SFT) assets recognised for accounting purposes (as calculated per paragraph 51 (i) of the leverage ratio standard)

A) Impacts on the income statement

If banks try to temporarily reduce gross SFT assets recognised for accounting purposes (hereinafter (1)) around the reference date, they need to adjust their securities holding. In doing so, however, they also need to consider impacts on their income statement, and hence this adjustment is inherently limited. Given this, with respect to (1), Japanese banks are of the view that gap between exposures in the middle of the term and the term-end may arise from banks' sound pre-funding activity and customer behaviour as mentioned above but this exposure is unlikely to trigger an intention of window-dressing for the purpose of raising the leverage ratio.

B) Effects of disclosure of the daily average value of the liquidity coverage ratio (LCR)

The international agreement requires banks to disclose the daily average value of LCR on a quarterly basis. Japan has already implemented this disclosure requirement in its national regulatory framework. Whereas, to our understanding, some jurisdictions have not implemented the disclosure of daily averaging of LCR. In jurisdictions, like Japan, that have already implemented this disclosure requirement, if the outstanding amount of government bonds and central bank reserves changes significantly during the period, the LCR daily average values reflect such a change in the LCR's numerator as a change in high-quality liquid assets (HQLA). Therefore, relevant authorities are able to capture such a change by comparing with period-end values. Furthermore, in Japan, the LCR regulation requires Japanese banks to hold a considerable amount of government bonds and central bank reserves on a daily basis. Therefore, it is difficult for them in the first place to significantly adjust their holding of government bonds and central bank reserves on a daily basis.

Requiring additional disclosure requirements through the leverage ratio regulatory framework as proposed by BCBS would impose overlapped regulatory burdens on banks as they have already implemented the requirement to disclose the daily average value of HQLA (e.g. government bonds and central bank reserves), as the numerator of LCR.

(2) Replacement cost (RC) of derivative exposures

A) Impacts on the income statement and the cancellation cost incurred

Similarly to (1) above, if banks try to temporarily reduce RC of derivative exposures (hereinafter (2)) around the reference date, they need to cancel their derivatives transactions. In doing so, however, they also need to consider impacts on the income statement and cancellation cost which will be incurred, and hence this adjustment is inherently limited.

In addition, the gap between exposures in the middle of the term and the term-end for (2) is primarily due to changes linked to markets.

(3) Central bank reserves that are included in on-balance sheet exposures

A) Differences in the treatment of central bank reserves in the leverage ratio framework across jurisdictions

To our understanding, some jurisdictions exclude central bank reserves from leverage exposures under certain conditions or give banks discretion to make such an exclusion, whereas this practice is not currently permitted in Japan. Therefore, if Japanese banks have their repo transactions change significantly during the period, such a change will just be reflected in central bank reserves from the perspective of leverage exposures, causing a neutral effect on the leverage ratio. In this view, for Japanese banks, while there may be changes in central bank reserves due to changes in call loan funding, there is only a limited opportunity for the leverage ratio window-dressing by means of significant adjustments to repo transactions. Given the differences in the treatment of central bank reserves across jurisdictions as discussed above, we respectfully request BCBS to take appropriate actions after considering actual practices of respective jurisdictions, rather than to impose globally-uniform disclosure requirements.

In addition, the following should also be taken into account for the same reason as the exposure item (1) above.

B) Effects of disclosure of the daily average value of the liquidity coverage ratio (LCR)

(Response to BCBS's question)

As discussed above, in Japan, central bank reserves are included in leverage exposures, and banks raise and manage funds according to respective liquidity needs in a way to have a neutral impact on the leverage ratio. With respect to BCBS's question as to whether the proposed disclosure of the average values of central bank reserves could have an impact on banks' willingness to utilise central bank liquidity facilities, we do not anticipate any particular impact because such facilities are supposed to be utilised only in emergencies and it is difficult to assume that banks will determine not to utilise the facilities just because these information will be disclosed.

<<Specific requests with regard to Pillar 3 (Disclosure)>>

1. Jurisdictional flexibility

We believe that it is inappropriate to enhance Pillar 3 in order to mitigate window-dressing behaviours. Furthermore, it is unreasonable to uniformly enhance Pillar 3, including those jurisdictions with no material gap between exposures in the middle of the term and the term-end, jurisdictions where misunderstanding was solved through QIS and supervisory dialogues, and jurisdictions that achieve sufficient outcome through Pillar 2.

Therefore, flexibility should be given to relevant authorities of each jurisdiction in determining, for example, whether to enhance Pillar 3 and how to implement specific approaches.

If, however, it is concluded that supervisory preventive measures on window-dressing behaviour are insufficient in Japan and thus revisions to the disclosure requirements (e.g. inclusion of average values) are judged as necessary, we respectfully request to take into account our specific proposals provided in 2 to 3 below on the specific calculation methods that are deemed to be practical and appropriate in light of practices of Japanese market.

2. Specific proposals on each exposure item

We believe that the approach proposed in the consultative document to limit exposure items that will be subject to the disclosure requirements is appropriate. Aside from these three items proposed in the consultative document, we have not identified any other exposures that could be subject to the manipulation or motivation of window-dressing to some extent. Based on this viewpoint, the following provides Japanese banks' views on "feasibility of data aggregation" for each of the three exposure items.

(1) Adjusted gross securities financial transaction (SFT) assets recognised for accounting purposes (as calculated per paragraph 51 (i) of the leverage ratio standard)

In light of BCBS's objective of mitigating window-dressing and banks' practices, the following treatments should be allowed for data aggregation.

A) Using balance sheet amounts

BCBS's objective of mitigating window-dressing can be achieved sufficiently by verifying balance sheet amounts, and therefore the use of balance sheet amounts should be permitted. Specifically, for Pilar 3 requirement, we respectfully request BCBS to delete the phrase "as calculated per paragraph 51 (i) of the leverage ratio standard," which is stated in *the Basel III: Finalising post-crisis reforms* published in December 2017.

This is because that, while the average balance sheet amount of repo transactions is currently calculated at the daily average value on a semiannual basis (excluding some group entities), the daily average value of leverage exposures is not calculated under current practice, and therefore to calculate such a value is expected to incur a considerable amount of costs.

B) Proportionality on data: Limiting the scope of entities, locations and transactions subject to data aggregation

Banks should be allowed to limit the scope of group entities, locations and transactions that will be subject to data aggregation based on the materiality provided that they clearly define and show their assumptions, etc. While it requires a considerable amount of burdens to aggregate data that are spread across the world and the group, we believe that the objective of mitigating window-dressing can be achieved by covering the data of key locations and transactions. Group entities, locations and transactions that are deemed as immaterial (e.g. immaterial relative to the group's total assets) should be excluded from data aggregation or permitted to be aggregated on a basis of quarter-end balances.

C) Omitting consolidation adjustments including intercompany transaction elimination and various closing adjustments and Using management-based data

In order to calculate the precise average value on a consolidated basis, it is necessary to reflect intercompany transaction elimination and various closing adjustments in the balance data, which is expected to require significant additional system development and operational burdens. Given this, we respectfully request the BCBS to allow banks not to reflect intercompany transaction elimination and various closing adjustments, to the average value in all cases regardless of the materiality.

Banks should also be allowed to use data for internal management purpose provided that they clearly define assumptions, etc. If the objective of disclosing the daily average value is to identify a gap between exposures in the middle of the term and the term-end, it is not meaningful to make a comparison with quarter-end financial data, and capturing management-based daily values for particular items would suffice.

(2) Replacement cost (RC) of derivative exposures

A) Using balance sheet amounts

Banks should be allowed to use balance sheet amounts (e.g. derivatives assets based on the present value that does not reflect collateral effects) as an alternative. As mentioned in the 2. (1) A) on the page 7, verifying balance sheet amounts can sufficiently and more efficiently fulfil the objective of mitigating window-dressing.

Furthermore, for the same reason as the exposure item (1) above, the following treatments proposed for the exposure item (1) should also be permitted for the exposure item (2).

B) Proportionality on data: Limiting the scope of entities, locations and transactions subject to data aggregation

C) Omitting consolidation adjustments including intercompany transaction elimination and various closing adjustments and Using management-based data

(3) Central bank reserves that are included in on-balance sheet exposures

For the same reasons discussed for the exposure item (1) above, the following treatment should also be allowed for central bank reserves.

B) Proportionality on data: Limiting the scope of entities, locations and transactions subject to data aggregation

C) Using management-based data

3. Regulatory framework consistent with the principle of proportionality (quantitative thresholds)

This regulatory framework should not be applied uniformly to all internationally active banks but instead quantitative thresholds should be established.

Some banks have only small exposures to those disclosure items relative to their total exposures, and therefore have a limited opportunity to manipulate the leverage ratio through such disclosure items, which indicates that there is no incentive for window-dressing. Given this, it is inappropriate to uniformly require such banks to disclose average of daily values. BCBS should establish quantitative thresholds, for example, requiring the disclosure of daily average values only in the case the percentage of the disclosure items exceeds a certain level.

In the case of a bank with a small proportion of derivative exposures, a certain degree of discretion should be allowed for each bank from the perspective of consistency with each bank's business model and actual conditions of transactions. For example, such simple calculation method should be allowed that the frequency of updating market parameters in the evaluation of financial derivatives held is determined by each bank.