May 25, 2018

Comments on the consultative document: *Pillar 3 disclosure requirements – updated framework*, issued by the Basel Committee on Banking Supervision

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for the opportunity to comment on the consultative document: *Pillar 3 disclosure requirements – updated framework*, issued on February 27, 2018 by the Basel Committee on Banking Supervision ("BCBS") and also appreciate the opportunity to exchange opinions between the BCBS and stakeholders such as financial institutions through the industry outreach meeting.

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

To our understanding, some major jurisdictions have not yet implemented Pillar 3 disclosure requirements. However, to ensure level playing field, we strongly request that the BCBS will encourage timely, appropriate and globally-consistent implementation of Pillar 3 disclosure requirements.

<<Particularly important issues>>

1. Granularity with respect to disclosure of a template used for benchmarking (Template BEN2)

We oppose the proposal to disclose risk-weighted assets ("RWA") at the risk category and asset class levels because there is a concern that such a disclosure requirement may mislead market participants or may reveal business strategies.

More specifically, misunderstanding that may be caused among market participants relates to comparability between the standardised approach ("SA") and the internal rating-based approach ("IRB"). The SA is a framework that focuses on simplicity and thus is less risk sensitive relative to the IRB. Unlike supervisors or rating agencies, however, general investors do not necessarily have an accurate understanding of such differences between the two approaches and it is impractical for financial institutions to accurately communicate to them the differences between the approaches, their regulatory positioning and factors of the differences. It is our concern that consequently, some general investors may interpret data based on the SA and the IRB equally without sufficiently taking into account differences in features between the approaches.

Furthermore, if banks' portfolio breakdowns are disclosed in detail and, as a result, banks' future business strategy would be revealed, such a disclosure may impede the implementation of the strategy.

For example, if an asset class having a significant difference between IRB based and SA based RWA is disclosed, the market may speculate that the bank is highly likely to take some actions (e.g. reduction) on that asset in the future, causing worries of the customer which relates to that asset or undermining negotiation power or worsening terms and conditions of the transaction upon executing that reduction or other actions.

2. Ensuring a flexible disclosure framework for encumbered assets (Template ENC) by allowing national discretion

In the industry outreach meeting, the public sector has clarified that Template ENC requires only columns (d) (Encumbered Asset Total), (h) (Unencumbered Asset Total) and (i) (Total) to be completed, giving discretion to national supervisors whether to provide breakdowns thereof; and with respect to the rows, the breakdown is required to be "as much disaggregation as desired". We appreciate the public sector internationally agreeing to design Template ENC, while designated as a fixed format, in a way that allows flexible approaches in light of current circumstances of each jurisdiction. On the other hand, Template ENC gives specific breakdown examples by presenting columns (a) to (c) and (e) to (g). But such examples may be interpreted as a fait accompli and therefore they should be deleted in order to better clarify that flexible approaches are definitely allowed for this disclosure requirement.

The reasons for our suggestion above are, firstly, while a national discretion is allowed for the breakdown of rows and columns, providing specific breakdown examples may give rise to misunderstanding that such examples are an internationally-agreed standard form of breakdowns (even though the examples provided are a practice applicable only to some jurisdictions).

Secondly, particularly with respect to the categories of unencumbered assets presented as a breakdown example (i.e. columns (e), (f) and (g)), no explanation is given in section 2 "New disclosure requirements on asset encumbrance" of the Consultative Document in page 7 and also no definition is stipulated in existing regulatory frameworks (e.g. liquidity). Also, the disclosure based on the categories of unencumbered assets provided as a breakdown example is not considered to be meaningful in terms of comparability.

Furthermore, while the Consultative Document proposes to separately disclose assets supporting central bank facilities in the “optional” column, it is unnecessary to specify this column in Template ENC because whether disclosing breakdowns of the column is left to the discretion of jurisdictions (“as much disaggregation as desired”). Therefore, it is requested to modify the description in the “Format” paragraph (i.e. “This is illustrated by the “optional” column in the template below.”) to specify that jurisdictions and banks that are already including assets supporting central bank facilities in current disclosures are not required to make such a disclosure in this template.

The following is our proposed modified description for the “Format” paragraph: “This is illustrated by the ‘optional’ column in the template below. Note that existing format(s) other than below template suffice for jurisdictions and banks that currently disclose asset encumbrance including exposures to central banks.”

3. Globally-consistent disclosure

We request to consider minimising regulatory burdens arising from disclosure of templates and tables.

The timing of implementing additions and revisions of the tables and templates proposed in the Consultative Document is completely aligned with the timing of regulatory implementation proposed in the finalised Basel III framework which has been recently agreed upon. To respond to such Basel regime reforms, banks need to revise their logic and calculation systems. Allocating additional resources (e.g. budget and human resources) to address the updated Pillar 3 framework under such circumstances will impose significant burdens on banks.

Therefore, it is requested to deconcentrate burdens for regulatory implementation as much as practical by, for example, prioritizing the tables and templates proposed in the Consultative Document and setting different implementation dates between important and less-important disclosures.

Particularly as for Template ENC, we request that its implementation date to be amended to January 2022 or later dates because it is not a template that directly relates to internationally-agreed regulations.

In the first place, actions taken for national implementation of disclosure requirements vary across jurisdictions. From the perspective of level playing field, the BCBS should review the implementation date in order to ensure that the timing of implementation and the granularity level of disclosures are globally consistent.

<<Other issues>>

1. Credit risk (Templates CR4 to CR6)

(1) Disclosure method of equity exposures

The BCBS should clarify that equity exposures will not be included in Template CR6.

(2) Definition of exposures in Template CR5

With respect to total credit exposure amount by risk weights to be disclosed in the lowest row of Template CR5, please clarify whether the "On-balance sheet gross exposure" and "Off-balance sheet gross exposure (pre-CCF)" should be the amount of exposure pre-CRM or post-CRM.

2. Operational risk (Template OR1)

・ Historical loss data before 2018

For purposes of capital calculation under the finalised Basel III framework, non-AMA banks are allowed to use loss data of past five years, instead of past 10 years, to calculate the Loss Component in the transition period at national discretion. If such banks do not have loss data of past five years, they are allowed to calculate the capital requirement based solely on the BI Component.

On the other hand, the Consultative Document basically requires banks to disclose loss data of past 10 years but allows them to disclose loss data of "fewer years" if permitted by national supervisors to do so in their capital calculation on a transitional basis.

However, the availability of loss data prior to 2018 is limited and it is impossible to retrospectively capture historical data. Therefore, if those banks that are permitted to apply transitional arrangements under the finalised Basel III framework are required to disclose historical loss data, it is expected that they will disclose data extracted under certain conditions determined by respective banks. In such cases, the loss data prior to 2018 may lack accuracy because the definition of loss data proposed in the Consultative Document is partially different from the definition under the Basel II framework and would lack comparability given that actual practices associated with loss data collection currently vary between banks.

In this view, we consider that disclosure of loss data prior to 2018 will not be useful for investors and external rating agencies and therefore request the BCBS to consider allowing non-AMA banks to choose not to disclose loss data prior to 2018 as a transitional arrangement.

Furthermore, if the definition of loss data will be changed, we request to also consider allowing banks applying AMA to choose to use loss data of five years because they may need to take some actions to address such a change, including system development.

3. CVA (Template CVA3)

The breakdowns proposed to be disclosed in Template CVA3: "Of which, counterparties with liquid credit spreads" and "Of which, counterparties with proxied credit spreads" (i.e. columns a8/a9 and columns b8/b9) could give rise to unintended effects and thus should be deleted.

As reported in "CVA Risk Management Working Group Report – Towards the Introduction of Market-based CVA" (Secretariat office: JBA)[1], the number of instruments tradable in the CDS market is small and liquidity is low in Japan relative to the U.S. or Europe and thus available CDS transaction data are insufficient, which is a major hurdle for the use of market-based PD (liquid credit spreads).

As a result, the percentage of capital charge relating to counterparties with proxied credit spreads may be excessive in the case of Japanese banks compared to foreign banks in the U.S. and Europe, which may undermine comparability between them. Furthermore, a common understanding is not necessarily fostered sufficiently with respect to the definition of liquid credit spreads, which may undermine comparability between Japanese banks as well.

Similarly to Japan, Asian markets and other non-U.S./non-European markets are considered to be facing the same situation stated above where the number of instruments tradable in the CDS market is small and a major hurdle for the use of market-based PD exists. Therefore, disclosing these breakdowns may give rise to unintended effects contradicting the enhancement of the reliability of the financial market.

Given the above, we consider that the disclosure of these breakdowns regarding capital charge for counterparties with liquid credit spreads and capital charge for

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1 "CVA Risk Management Working Group Report -Towards the Introduction of Market-based CVA" (issued by JBA on June 29, 2017) (https://www.zenginkyo.or.jp/en/news/detail/nid/8177/)

counterparties with proxied credit spreads are inappropriate and thus should be deleted from Template CVA3.

4. Benchmarking (Templates BEN1 and BEN2)

(1) Equity investments in funds

According to the note to Template BEN1 regarding Residual RWA (row 7), it is required to include equity investments in funds (rows 12 to 14 in Template OV1) in this row 7.

In the proposed Template BEN1, rows 7a/7b are designed in a way that banks cannot fill in applicable data. However, there are equity investments in funds to which the IRB can be applied (e.g. loan funds) and thus such rows should be re-designed to enable banks to fill in applicable data.

In general, it would be preferable that the design of the template is aligned with the practice of RWA calculation.

(2) Scope of disclosure (Treatment of funds)

To our understanding, Template BEN2 is a template which further elaborates on "Credit risk (excluding counterparty credit risk)" disclosed in row 1 of Template BEN1 by providing data at asset class level. With respect to fund investments, for example, it is noted in Template BEN1 that they should be included in "Residual RWA" (row 7) rather than "Credit risk (excluding counterparty credit risk)" (row 1) whereas Template BEN2 requires to include them in "Others (including funds)"(row 8). To ensure consistency between these two templates, it is requested specifically to consider deleting the row of "Others (including funds)".

For example, it is our understanding that if fund investments are included in row 7 ("Residual RWA") of Template BEN1, they will not be included in Template BEN2. However, the proposed Template BEN2 is fixed and contains row 8 requiring disclosure of "Others (including funds)". This gives confusion as to how relevant figures should be reported.

5. Capital distribution constraints (Template CDC)

This template should be deleted because it is considered to be unnecessary as an internationally-agreed template for the following reasons.

Firstly, disclosure of the percentage of CET1 available is already required in other templates (e.g. row 12 of Template KM1), which means that the concept of Template CDC partially overlaps with others.

Secondly, as being pointed out by the BCBS, Pillar 2 requirements are sensitive information of national supervisors and therefore, it would be inappropriate to require the private sector to disclose such information.

Lastly, approaches taken to apply Pillar 2 requirements differ across jurisdictions (national supervisors) and this comparability issue may mislead investors.