September 19, 2014

Comments on the Basel Committee on Banking Supervision's Consultative Document: Supervisory guidelines for identifying and dealing with weak banks

Japanese Bankers Association

We, the Japanese Bankers Association, would like to express our gratitude for this opportunity to comment on the consultative document: *Supervisory guidelines for identifying and dealing with weak banks*, released on June 18, 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.

1. Stress testing (Paragraphs 52 and56)

We recognise that stress testing is an effective means for bank supervision purposes. Nevertheless, if stress test results will be used by supervisors as one of the factors to make decisions on their corrective action (e.g. actions that may impose a restriction on the latitude of banks' business management, including business improvement order, business suspension order and intervention in a capital policy), certain concerns should be taken into account. Specifically, while stress test results are significantly dependent on the depth of stress scenarios, the assessment of the depth of the stress scenarios involves a subjective judgment. In addition, even where the same scenarios are applied, the result may differ across banks because such result relies on loss estimation models.

Further, if the BCBS actually puts in place a framework where the stress test results are linked to action taken by supervisors, there may be following concerns:

(1) In the case of cross-border financial institutions (e.g. a branch/subsidiary in a host country), if supervisory action by a host authority is taken based on the stress test results in the host country, the financial institution's business in that country may be constrained (e.g. restrictions on the remittance to the home country and the distribution of dividends). In addition, the level of required robustness of stress test scenarios is expected to differ across jurisdictions, which may give rise to unfairness and thus may undermine the level playing field among financial institutions; and

(2) Loss estimation models may differ across banks. Therefore, even if scenarios with the same level of depth are applied to the same asset and liability items, the result could differ across banks. Further, the more extreme a scenario is, the larger the

difference in the results across banks because the result is dependent on the respective models.

2. Corrective action (Paragraph 107)

Decisions on whether to take corrective action should be made by using different kinds of indicators or tools, but should not be based on a single indicator or tool. Therefore, the BCBS is requested to stipulate that such corrective action should be taken in accordance with comprehensive judgment.

Further, while it is understandable to use market indicators as one of objective factors to make those decisions, a more specific and careful discussion is called for in determining whether it is reasonable to use them as a trigger for a corrective action. This is because market indicators, depending on their types, are susceptible to those market conditions and other factors that are not directly related to credit quality and soundness of individual banks. Additionally, the spillover effect of such indicators may trigger negative chain reactions.

3. Public disclosure of problems (Paragraphs 231 to 237)

We agree that public disclosure of individual financial institutions' problems has positive effects, including contribution to the soundness and stability of financial markets. At the same time, we consider that sufficient communication regarding the public disclosure between the supervisors and the markets is needed and thus should be explicitly required in the supervisory guidelines. Such enhancement of communication is indispensable particularly when stress test results are used as one of the factors to identify weak banks. Further, the supervisory guidelines should also stipulate that when publicly disclosing weak banks identified, the supervisor and such banks need to have enough dialogue in advance.

Moreover, lack of ability to appropriately interpret disclosed information may increase uncertainty in the financial markets, only bringing about significant negative effects of the public disclosure. Further, the public disclosure of identified weak banks may trigger concerns about the financial system, and may also undermine the ability of self-sustained recovery by such banks, giving rise to negative chain reactions. The BCBS is requested to ensure that such banks are not deprived of the opportunity to fulfill accountability about, among other things, their business models, characteristics and conditions and recovery plan.