March 17, 2016

Comment on the Consultative Document: Identification and measurement of step-in risk

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on the consultative document: *Identification and measurement of step-in risk* issued by the Basel Committee on Banking Supervision (the "BCBS").

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

≪**Summary**≫

○ We disagree with managing step-in risks in the "Pillar 1" framework. We note that the size and nature of shadow banking sectors greatly vary across jurisdictions, and any implicit support to such shadow banking entities and its extent may be significantly affected by individual factors such as the contract terms and business relationship. In addition, other factors including business models, business practices, legal systems and bank supervision frameworks differ across jurisdictions and so, managing step-in risks under the globally uniform "Pillar 1" framework is not considered to be adequate.

○ We believe that the scope of entities subject to identification and measurement of step-in risks proposed in this Consultative Document is more far-reaching and less clear than the scope of shadow banking entities specified by the Financial Stability Board ("FSB"). The BCBS should fully recognize that the objective of this Consultative Document is based on the FSB's policy objective "to monitor and supervise shadow banking entities properly", and should narrow down the scope of entities subject to identification and measurement of step-in risks so as to be aligned with the FSB's approach.

○ Given that a number of actions and new or enhanced regulations implemented both by the FSB and the BCBS to address shadow banking risks as well as other regulatory reforms in some jurisdictions (e.g. UK ring-fencing, US Volcker rule etc.) have been already implemented following financial crisis, the BCBS should, toward finalizing this Consultative Document, narrow down shadow banking risks to what actually needs to be additionally captured, carefully considering it so as not to bring overlapping regulatory overburden.

○ In capturing step-in risks, we believe that the BCBS should not widen the gap between the scope of regulatory consolidation and that of accounting consolidation. Given that the scope of consolidation provides a basis for understanding financial information, widening the gap between the scope of regulatory consolidation and that of accounting consolidation would possibly lead to confusion of users of financial statements. In addition, preparing two different financial statements for both regulatory and accounting purposes in a timely manner is not seen as appropriate, since it would lead to significant increase in practical burden of financial institutions.

≪General Comments≫

(1) Overly conservative regulatory framework

(i) We disagree with the BCBS's proposal to manage step-in risks in the "Pillar 1" framework.

As clearly stated in "Global Shadow Banking Monitoring Report 2015" issued by the FSB, the size and nature of shadow banking sectors greatly vary across jurisdictions. In addition, any implicit support to such shadow banking entities and its extent may be significantly affected by individual factors such as the contract terms and business relationship with the clients as well as bank-specific factors. Furthermore, we may assume that the criteria to be relied upon may evolve along with the development of financial technologies. Given that other factors including business models, business practices, legal systems and bank supervision frameworks differ across jurisdictions, we assume that managing step-in risks under the globally uniform "Pillar 1" framework may result in regulatory overburden for certain jurisdiction(s) and may possibly undermine the soundness of financial system(s) thereof. In addition, such regulation may undermine the functionality of shadow baking sectors as market-based finance providers. For example, the shadow banking sectors with undermined functionality as market-based finance may inhibit the Japan's initiatives to encourage the shift of money "from savings to investment" through further utilizing asset management activities and funds aiming at sustainable economic growth and virtuous economic cycle.

If the BCBS requires the banks to impose capital charge to such potential risks as step-in risks in the "Pillar 1" framework, taken by shadow banking sectors' role serving as market-based finance providers would be taken over by the banks in advance, which would make the banks more heavily exposed to such risks.

As illustrated in "5.2. Collective rebuttals" of this Consultative Document (p.29), step-in risks can be shut off or mitigated through the legislative or regulatory framework provided by each jurisdiction. Thus, we support the concept that each jurisdiction's regulator properly captures step-in risks as necessary, in consideration of the size and nature of shadow

banking sectors specific to each jurisdiction as well as each jurisdiction's statutory regulations to shut off step-in risks from occurring.

We believe that the BCBS should not forget an aspect of the shadow banking sectors' important role in supplying fund to the real economy and the financial system as well as risk-taking. The BCBS is trying to capture potential risks taken by shadow banking entities "completely" and "entirely" through implementation of the regulatory framework proposed in this Consultative Document. We believe this is very much like cutting down all trees as they may cause wildfire. The BCBS needs to consider which is better for the existing ecosystem – large scale deforestation as they may cause wildfire or managing and maintaining forest to keep ecological productivity – through revisiting the whole picture from a wider view, when discussing the optimal policy approach for the future.

(ii) <u>The scope of entities subject to identification and measurement of step-in risks</u>

The "Global Shadow Banking Monitoring Report 2015" issued by the FSB narrows down the requirements for monitored entities in accordance with economic function-based classification and refers to the possibility that certain entities that may not pose shadow banking risks were included in the scope of shadow banking entities. The scope of this Consultative Document, by mentioning "without limiting the proposals to them [shadow banking entities]", definitely treats wide-ranging shadow banking entities than that envisaged by the FSB, and the scope itself is unclear. We believe that if the scope remains unclear then the framework would not meet the requirement to "be readily operational" (Principle 4).

We understand that the aim of workstream established by the FSB ("WS1") was to monitor shadow banking entities and strengthen the regulation by discussing the "regulations related to relationships between banks and shadow banking entities." Accordingly, the BCBS should reaffirm that the objective of this Consultative Document is based on the FSB's policy objective to "monitor and supervise shadow banking sectors properly", and clarify that the scope subject to identification and measurement of step-in risks is limited to shadow banking entities. When determining the scope of shadow banking entities, we believe that the BCBS may adopt the "economic functions"-based classification approach used in the FSB's "Global Shadow Banking Monitoring Report 2015".

(iii) <u>The effectiveness of the shadow banking regulations and others implemented after the financial crisis should be taken into account.</u>

Before the issuance of this Consultative Document, the WS1 has already enhanced the regulatory framework through regulations such as "Capital requirements for banks' equity investments in funds" and "Supervisory framework for measuring and controlling large exposures." As described in this Consultative Document, we see many regulatory reforms have been undertaken steadily to date, including reforms by the BCBS and other reforms undertaken by national authorities (i.e. UK ring-fencing, US Volcker rule, etc.). In finalizing

this Consultative Document, we expect the BCBS to narrow down the scope of shadow banking risks to what actually needs to be additionally captured, carefully considering it so as not to bring overlapping regulatory overburden in view of the fact that these enhanced regulations and various reforms have been already put in place.

(2) Insufficient evaluation of the effect and impact on other Basel regulations

As described in paragraph 14 (p.4) of this Consultative Document, we understand that the framework to capture risks related to each risk category of banks (i.e. credit risk, market risk, operational risk and liquidity risk) has been already established through the defined frameworks including capital requirements and liquidity requirements. In addition, the rules have been already put in place to impose capital charge for economic interests of banks in funds and securitization transactions according to certain criteria.

In this Consultative Document, the BCBS has not shown the specific examples of how banks would be affected by step-in risks (e.g. in terms of capital and liquidity requirement). In Japan, we have not experienced any step-in cases during the financial crisis and its impact was little or none. Therefore, we believe that it is difficult to evaluate the nature of such risks. If various regulations implemented without any adjustments resulting in regulatory overburden, it may possibly lead to certain issues such as market disruption or distortion, then global economic activities by private sector companies may be also adversely affected. Assuming that the consolidated approach is to be applied, banks will be required to implement a detailed quantification and management for market risk and operational risk arising from step-in risk. We are skeptical about if managing such risks would be necessary in reality along with the management of step-in risks.

If the consolidated approach proposed in this Consultative Document were to be applied, we assume that daily and monthly monitoring of the Liquidity Coverage Ratio (LCR) and leverage ratio would be required by consolidating the data of those entities that are not consolidated for accounting purpose. Given that it is difficult to obtain information in a timely manner from an entity that is not included in scope of accounting consolidation, the bank may fail to comply with these existing regulations. Notwithstanding, the BCBS has not made any particular reference to such anticipated impact in this Consultative Document. Thus, we believe that the BCBS should analyze and consider how this Consultative Document, if applied, would affect other Basel regulations such as capital requirements and liquidity requirements, before determining the basic direction of the regulation for managing step-in risks..

(3) Gap between the scope of regulatory consolidation and accounting consolidation

We believe that the BCBS should not widen the gap between the scope of accounting consolidation and that of regulatory consolidation when capturing step-in risks.

The scope of consolidation provides a basis for understanding financial information.

Widening the gap between the scope of disclosed regulatory consolidation would not be desirable in terms of ensuring effective market discipline based on the fact that disclosed accounting and regulatory financial information (e.g. information of RWA) is widely divergent. According to Basel II capital framework document, the BCBS noted its intension to make efforts to reduce, wherever possible, "inappropriate disparities" between regulatory and accounting consolidation scopes. In addition, "Revised Pillar 3 disclosure requirements" issued by the BCBS in January 2015 require reporting of reconciliation and differences between accounting and regulatory financial statements. Considering the comments provided by users of financial statements such as investors in the global discussion concerning the disclosure requirements (i.e. EDTF etc.), we believe that certain users of financial statements may not fully understand the various differences between the data based on financial accounting standard and that based on regulatory standard. Further widening the gap may possibly disrupt users of financial statement and undermine the transparency of information disclosed.

In addition, preparing two different financial statements for both regulatory and accounting purposes would lead to significant increase in practical burden of financial institutions. In particular, we are concerned about the significant impact in practical burden in the jurisdictions (including Japan) where the scope of accounting consolidation has been aligned with that of regulatory consolidation. If the scope of regulatory consolidation is extended and covers more than that of accounting consolidation, it will be necessary to timely obtain information from entities that are not included in scope of accounting consolidation, which we assume would be extremely impracticable. We believe that the BCBS should carefully discuss certain factors, including feasibility to have control over in-scope entities for risk management purpose, feasibility to request data submission from such entities and operational burden in practices.

≪**Specific Comments**≫

1. Proposed conceptual framework

Q1. What are commenters' views on the four overarching principles? Are there any others that should be included?

(1) Principle 1 "The framework should anticipate the situation after a step-in."

As stated in this Consultative Document, we believe that focus of step-in risk identification and measurement should be placed on whether the step-in risks of the respective banks would eventually "affect the financial system." The framework proposed in this Consultative Document is structured to identify step-in risks mechanically if, for example, the voting interest reaches certain threshold, which may possibly capture certain risks that cannot always pose systemic risk, and we believe that the BCBS should revisit the proposed framework.

(2) Principle 2 "The framework should be simple and should foster consistent implementation."

We believe that it would not be "simple" if the scope of regulatory consolidation, with an aim to capture the step-in risk, covers more wide-ranging than that of accounting consolidation. According to paragraph 11 (p.3) of the Discussion Paper "The regulatory framework: balancing risk sensitivity, simplicity and comparability" issued by the BCBS in July 2013, ideal simple capital standard "avoids reliance on inputs not captured within the normal accounting or risk management systems of banks." However, the proposal in this Consultative Document is not consistent with that concept.

(3) Principle 3 "The framework should be conservative, risk-sensitive and proportional."

If the framework is "conservative," we are concerned that certain issues may arise, including overlapping regulations. Given that step-in risks need to be identified and measured not "conservatively" but "appropriately," we believe that the BCBS should revise the text of the principle to "the framework should be 'appropriate', risk-sensitive and proportional."

We believe that the scope of capturing step-in risks based on implicit commitments should be limited to the extent considered reasonable. We note that the scope of assuming risks based on implicit commitments should be limited to the financial instruments that are designed in a way that a step-in by the bank would be justified based on a clear economic rationale. We consider it inadequate to overemphasize that banks would irrationally step-in in order to avoid extremely uncertain (or immeasurable) losses arising from reputational risk..

Considering that the risk assessment process proposed in this Consultative Document, including the "significant influence" criteria, is unclear, we believe that the proposed

framework is not likely to meet Principle 3 describing that excessively conservative judgement should be prevented, given that a more conservative judgement is made (or is required under supervision) in bank's ordinary risk management practice.

(4) Principle 4 "The framework should be readily operational."

The proposal of this Consultative Document includes in-scope entities that are not subject to management control and timely disclosure requirement. Under such circumstances, a bank needs to take processes by obtaining information required for risk measurement from such entities, asking a supervisor for a decision on whether the step-in risk identification is required for such entity and whether the assessment approach is adequate, and then perform procedures required for risk measurement and reporting. Considering that such processes including interaction with supervisors are repeatedly required at each reference date to identify step-in risks (usually at the end of each quarter period), we assume that the framework will not be readily operational.

2. Identifying step-in risk

(1) General view

We believe that most of "Primary indicators" and "Secondary indicators" are qualitative and consequently, step-in risks is difficult to identify. As aforementioned, whether step-in risk exists and its extent may be greatly affected by bank's business relationship with the customer and specific contract terms. Thus, we do not believe it adequate to apply such "one-size-fits-all" approach that step-in risks should mechanically be identified and captured for regulatory purpose by only meeting any one of the "Primary indicators" or "Secondary indicators". We believe that the BCBS should establish a framework where an entity with less likelihood of triggering step-in (e.g. finance company for which clearly demonstrates well-established and independent governance structure, such as those companies publicly listed) is excluded from the scope.

In addition, if entities are included in scope of regulatory consolidation mechanically by the existence of such indicator(s) explicitly or implicitly specified in the contractual agreement and others, we are concerned that the bank will be required to recognize RWA excessively. We believe that the BCBS should pay close attention not to determine the framework too conservatively, such as by taking into account the level of likelihood in step-in identification and measurement.

(2) Primary indicators

Q2. What are commenters' views on the proposed indicators for step-in risk? Are there any additional ones that the Committee should consider?

(i) Definition of ”upfront facilities”

When determining the definition of “upfront facilities”, the BCBS should clarify that purchase/investment in securitized products and/or notes or loans to securitization SPCs such as granting of senior loans are not always in scope of “upfront facilities.” If the definition of upfront facilities includes purchase/investment of securitized products and/or notes, and granting senior loans to the SPC serving as the securitization vehicle, such definition will be greatly different from the original objective of this regulation, i.e. identifying step-in risks. For example, where only senior loans are granted by a bank as an investor to an SPC, it is obvious that such bank is not proactively involved in the management of the SPC and no incentive to support the SPC when it fails.

(ii) “Significant influence” criteria etc.

We believe that the “significant influence” criteria have not been clearly defined. If paragraph 45 (p.13) of this Consultative Document is considered as a guiding “Principle” and banks are expected to identify and measure step-in risks only for entities that the bank serves as “sponsor” defined in that paragraph, we can expect that entities which are not relevant may be excluded from scope to certain extent. However, Example 2 (p.19) of this Consultative Document describes, in summary, that even in the case where Bank B consolidates an SPC because of its ‘majority’ voting rights in it, that SPC should be included in the scope of risk assessment by Bank A, which makes the criteria whether to include in scope is unclear. In cases where any other company serves as a parent of, and (fully) consolidates, an entity, all assets are attributable to the financial statements of the said parent. Thus, we believe that the bank other than the parent company holds certain portion of equity interests of the said subsidiary will not be required to perform risk assessment of such a subsidiary. (In Example 2, we consider that risk assessment coverage of Bank A and that of Bank B may be partly overlapping.)

We do not see reasonable grounds in applying voting interest model as determinant factor. The mechanistic assessment only based on the voting rights without taking into account other factors may result in significantly excessive risks compared to that assumed in the concept to avoid potential systemic implications, as presented in the objective of Principle 1. We note that both of the straight-forward voting interest model and the qualitative criteria to determine significant influence are taken into account when determining whether an entity should be consolidated for accounting purpose. Even if an entity is not consolidated for accounting purpose because the qualitative criteria are not met, such entity may be determined to be consolidated for regulatory purpose according to the said straight-forward classification, which results in excessively conservative risk assessment.

With respect to Principles 3 and 4, we are concerned that the proposed framework would become much less operational, because the difficulty of identifying and measuring

step-in risks is likely to result in that the bank may make decision too conservatively, or the bank seeks for the supervisor's consent for reasonableness of the risk identification scope as well as the risk assessment category every time of risk measurement.

Even if an entity is an equity-method affiliate, a step-in risk is shut off provided that it is ensured that significant influence cannot be exercised due to certain strict provisions under the relevant contracts etc. As such, we believe that the BCBS should not require the identification and measurement of step-in risks provided that the step-in risks are shut off by means other than the legal framework illustrated in this Consultative Document.

(iii) External rating

The BCBS should delete "10 | External credit rating based on a bank's own rating" from the Table of "Primary indicators." When determining whether an entity should be consolidated or not, information asymmetry exists between an audit firm, who has direct access to the bank's information for discussion, and other third parties including the credit rating agencies, who do not have such access, with respect to the bank's relationship with the said entity. In such circumstances, we do not believe it reasonable to conclude that an entity has implicit bank support only based on the outcome of rating process by the external credit rating agency although a bank and an audit firm involved in its financial statements audit have determined, through their discussion, that the bank has not substantial control over the said entity. Furthermore, such approach would be incompatible with the BCBS's policy direction to reduce mechanistic reliance on external credit ratings.

If an external credit rating were to be used as "primary indicator," we believe that the scope should be limited to entities such as SPC whose credit rating is mechanically linked to the relevant bank's credit rating due to certain reason such as "liquidity enhancement facility" granted by the bank. Any legal entity that executes business at its own judgement and its credit rating is not mechanically linked with the bank's credit rating (e.g. listed financial institutions) should not be included in the scope.

(3) Secondary indicators

Q3. What are commenters' views on the proposed secondary indicators for step-in risk? Are there any additional ones that the Committee should consider? Should any of them be considered as primary indicators?

While we may share the concept to propose secondary indicators, we consider that some proposed indicators will not work in reality.

It is highly likely that the decisions may vary among banks in evaluating most of secondary indicators. Thus, we consider that the BCBS should more specifically clarify the

criteria in determining when and where to evaluate step-in risks in order not to generate gaps in applied regulations among banks globally. In particular, a bank's judgement on other parties' situations would be required in evaluating certain factors such as (d) originator incentive (paragraph 54) and (i) composition of the investor base (paragraph 59), and therefore, we consider it difficult to reach consensus on judgement among banks.

While the BCBS stated in (e) that some entities may possibly be excluded from accounting consolidation, we are concerned that no specific background information has been provided in this Consultative Document, which can be considered problematic. Furthermore, certain qualitative indicators including "(investor) expectation" and "(investor) ability" in (h), (j) and (k) do not involve objectivity, and they would lead to diversity in practice and is not likely to be operational in reality. While the BCBS proposed that secondary indicators would be considered by both the supervisors and banks, we do not believe it realistic to determine the reasonableness of all judgements only by supervisors, without any other view like an audit by external auditors.

(4) Scope of entities subject to identification and measurement of step-in risks

(i) Entities that are already subject to Basel regulations

We consider that any entities subject to Basel regulations or other prudential supervision of the relevant supervisors and consolidated subsidiaries thereof should not be included in scope. This is because the banks have already incorporated risks for such entities, for example, in a way that certain portion of investments in such entities is deducted from regulatory capital subject to the double-gearing treatment. If such entity is consolidated, we see that the regulations are overlapping, which leads to regulatory overburden.

In accordance with the capital requirements applied in Japan, when calculating risk-weighted assets for mortgage-backed securities and the like, if (a) the amount of risk-weighted assets for subordinated exposure calculated using SFA (Supervisory Formula Approach) is larger than (b) the amount of risk-weighted assets of the underlying assets of the said securitized products, banks may apply the amount of (b) as risk-weighted assets. As such, the entire assets of the SPC as an issuing entity of that product have been recognized as risk-weighted assets in practice here in Japan[1]. We expect the BCBS to clarify that the process of identifying step-in risks is not required for cases where, if such process would be required, double counting would obviously arise.

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[1] (Reference) Excerpted provisions from Regulations to implement the Basel capital accord issued by the Financial Services Agency of Japan:

"**Article 255: Ceiling of required capital**

The aggregate amount of required capital for a securitized exposure in a securitized transaction held by a bank that applies an Internal Ratings-based (IRB) approach may be the same as or less than the amount calculated through application of the IRB approach to the underlying assets in relation to the said securitized exposure."

(ii) Project finance

Project finance generally represents a loan granted by a bank to an SPE established by a sponsor. Then we would like to confirm that project finance is not in scope subject to identification and measurement of step-in risks. While reference has been made to SPE as prominent example of step-in in this Consultative Document, the scope subject to identification and measurement of step-in risks has not been clearly defined. In the cases where a project finance SPE fails, it is not assumed that lender of senior debt would step in to bail in such SPE (in fact, we assume that the debt is protected/serviced through disposal of collateral pledged by project assets or sell-down or assignment of debt to new sponsor). Thus, such SPE should be excluded from scope.

(iii) Entities held for pure investment purpose

We believe that entities held for pure investment purpose (i.e. investment trusts, unit trusts, securitized products etc.) should be excluded from scope. Given that these entities are held for pure investment purpose, we never assume that a bank has any incentive for step-in.

3. Step-in risk assessment approaches

Q4. What are commenters' views on the different potential step-in risk assessment approaches? Are there any other approaches that the Committee should consider to account for step-in risks?

(While we provide a comment to this question to facilitate constructive discussion, we ask you to note that we disagree with managing step-in risks in the "Pillar 1" framework.)

(1) Consolidation approach

We disagree with applying full consolidation approach and proportionate consolidation approach, because taking such approaches may possibly require newly preparing financial statement for regulatory purpose in addition to the financial statements for accounting purpose. We consider that the BCBS should thoroughly reassess the definition of shadow banking risks to align with the FSB's policy objectives and then adopt any approach to measure step-in risks which allows a bank to take into account the actual impact on the financial system (a conversion approach that reflects such impact into conversion rate, etc. may be considered as an option).

The BCBS noted that, if consolidation approach is applied, it represents, for the purpose of prudential supervision, the most likely prudential treatment to replicate ex ante the banking group situation (paragraph 67 (p.20) of this Consultative Document). Meanwhile, if

the consolidation approach is applied, financial institutions are required to prepare consolidated financial statements for both accounting purpose and regulatory purpose and it may possibly lead to discrepancy between the accounting information disclosed and the RWA information disclosed, undermined investors' confidence on financial statements, and significant increase in practical burden. We believe that the costs caused by preparing two types of consolidated financial statements would overweigh the benefits for prudential supervision.

The BCBS has provided the definition of the scope of accounting consolidation and that of regulatory consolidation in paragraphs 30-31 (p.10) of this Consultative Document, but we think that those definitions have not been well-conceptualized. While the reference has been made to the concept of "controlling influence" for accounting consolidation scope, no reference has been made for regulatory consolidation scope. While this Consultative Document includes certain descriptions on multiple indicators and significant influence criteria and the like, we believe that it is very much unclear where the scope of in-scope entities is demarcated, given that the legal frameworks may differ among jurisdictions. If those definitions are not clearly conceptualized, we are concerned that it may be difficult to ensure consistency of the criteria to be implemented by national authorities among jurisdictions.

Paragraph 68 (p.20) of this Consultative Document states that "the Committee expects that the cases where a bank cannot gather the necessary information from an entity, over which it is exposed to a relevant risk of step in, are not common in practice." However, we note that it is extremely difficult in practice to obtain necessary information from an entity that a bank does not consolidate for accounting purpose. It is difficult to obtain such information even from an affiliated company, and in certain cases banks are forced to use such entities' financial statements for financial reporting purposes with more than three month time lag from reference dates.

In addition, this Consultative Document proposes certain approaches requiring adjustment of consolidation scope (i.e. full consolidation and proportionate consolidation approaches). Nevertheless, as described in paragraph 70 (p.21) of this Consultative Document, a step-in, once materialized, may not always result in accounting consolidation of the entity by a bank.

(2) Conversion approach

Determining the rate for conversion approach ("CCF") should be carefully discussed. While this proposal has not specified the level of CCF and its concept itself, we believe that the level of step-in risk should be lowered when, for example, there is any third party investor(s) or any company serves as its parent. We believe that it is obviously inadequate to map indicators to approaches and consistently apply one and the same CCF to all entities classified in a category. Accordingly, we expect the BCBS to assume various cases in

determining CCF and carefully discuss not to require the banks to recognize excessive risk weighted assets, for example, by applying CCF based on SA (Standardized Approach) even if the amount of expected bank support is immaterial. We are concerned that excessively conservative CCF would inhibit banks' capability to play essential roles to support the growth of business corporations by adversely impacting capital and liquidity ratios.

Even under the conversion approach, it would not be feasible to obtain the figures of the in-scope entities, such as their total assets, necessary for calculation under current practices. BCBS should fully take into account the feasibility faced by banks to achieve it and the necessity for each of information.

(3) Cases where an entity would not be included in scope of consolidation

While paragraph 68 (p.20) of this Consultative Document includes description that full consolidation would not be appropriate in certain cases, it has not been specifically described. We believe that the BCBS should clarify such cases so that the bank could determine when an entity would be excluded from scope of consolidation. We assume that an entity would not be included in scope of consolidation if the bank is not able to obtain the relevant information in a timely manner, but the BCBS should further clarify such cases envisaged.

Q5. What are commenters' views on the proposed mapping between the primary indicators and the potential approaches?

(While we provide a comment to this question to facilitate constructive discussion, we ask you to note that we disagree about managing step-in risks in the "Pillar 1" framework.)

The BCBS should carefully discuss on how equity-method affiliates should be managed in measuring step-in risks, taking into account certain factors including the treatment under the current regulatory framework (i.e. deductions from capital for the purpose of calculating the risk-weighted capital ratio, in principle) and likelihood of a step-in. We expect the BCBS to carefully discuss and determine the approach, in view that (a) in some cases, an equity-method affiliate is formed as a joint venture with other company(ies) and step-in risk does not exist depending on the terms of shareholders agreement(s) with the business partner(s), and (b) it is impracticable to obtain necessary information since the said affiliate is not consolidated for accounting purpose (even under the current practices, in some cases a bank is required to use the affiliated companies' financial statements for financial reporting purposes with more than three month time lag from reference dates).

4. Other matters

Q6. What are commenters' views on proportionate consolidation for joint-ventures?

We consider that the application of "consolidation" approach should be limited to cases, to the extent possible, where it is highly likely that the bank would consolidate the in-scope entity after a step-in.

Q7. What are commenters' views on risks stemming from banks' relationship with asset management activities and funds and the appropriateness of the direction envisaged?

The BCBS should clearly describe that funds held for pure investment purpose and of which a bank is not involved in its origination or custodian services should be excluded from the scope that is subject to identification and measurement of step-in risks. We never assume that a bank has any incentive for step-in for any funds held for pure investment purpose.

(1) Collective rebuttals

We believe that it is extremely difficult in practice for banks to investigate and determine whether a step-in is prohibited in accordance with the local laws and regulations of other jurisdictions at each reference date for assessing step-in risks. As the BCBS recaps and tabulates the countercyclical capital buffer levels determined and imposed by national authorities, we expect to develop similar framework under which the BCBS or national authorities to identify and disclose collective rebuttals of each jurisdiction in a comprehensive manner.

(2) Approach to determine step-in risks for funds

The BCBS should not employ uniform quantitative criteria, applied to the assets under management (AUM) as proposed in paragraph 88 (p.26) of this Consultative Document. Even if a fund is originated assuming that it is distributed to customers, a bank may temporarily inject capital as seed money, and we are concerned that applying only such quantitative criteria may possibly mislead the determination.

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