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Global Risk Watch Newsletter

Again, Critical Regulatory Reforms for the Management of Japanese Bank

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Overview of Development in Financial Regulations (Trends & Topics)

◆Again, Critical Regulatory Reforms for the Management of Japanese Bank (Koichi Iwai, Senior Manager, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.)

In this month, numerous important developments occurred for Japanese banks. The biggest focal point is the consultation paper published by the Basel Committee on Banking Supervision (BCBS) regarding 'Interest Rate Risk in the Banking Book (IRRBB)'. This consultation proposes two options (Pillar 1 and Pillar 2) for the capital treatment of interest rate risk in the banking book. The most fearful scenario for Japanese banks (Pillar 1 proposal only) was avoided; however, banks cannot be complacent by this. There is likelihood that Pillar 1 will be selected as mandatory requirements depending on various developments in the near future. In addition, the proposed Pillar 2 option includes quantitative disclosure of interest rate risk in the banking book based upon the Pillar 1 approach as well as contents to strengthen so-called 'Outlier regulations'. Therefore, a variety of burdens might be added on certain banks (banks operating internationally) in comparison with the current scheme.

The second development is the thematic review on supervisory framework and approaches for systemically important banks (SIBs) published by the Financial Stability Board. The proposed directions on future financial supervisions are: (1) for supervisory authorities to clearly define their supervisory strategy and priorities in line with their 'Risk Appetite'; (2) promote further dialogues between authorities and banks and so on. To define supervisors' own risk appetites is a new concept. Furthermore, the objectives of strengthening dialogues among authorities and banks is said to promote mutual understandings regarding bank's business model, governance, and risk culture. In line with this argument, Japanese FSA specified future supervisory policies to focus on dialogues with various parties such as bank's external board of directors, business units, and internal audit units.

The third is development regarding conduct risk. Financial Conduct Authority (FCA) in UK that has been the biggest advocate for the conduct risk has announced its detailed plan to investigate misconducts in the primary markets.

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Furthermore, the agency also published long-awaited final report on ‘Fair and Effective Market Review (FEMR)’ that has been underway since last year. Especially, the latter is aiming for the fundamental reforms of the wholesale market. The IOSCO (International Organization of Securities Commissions), as well as various international authorities and the US authorities also have carefully followed this. FEMR report indicated: (1) to establish global standard (standards of practice, qualification criteria, etc.) for the FICC (Fixed Income and Commodity and Currency) market; (2) to strengthen regulations in UK FICC markets; (3) to identify conduct risks through enhanced market surveillance, and so on. The contents of standard and regulation are unclear. However, a foreseeable future of stricter stance posed by the authorities towards the wholesale market is inevitable.

The final critical trend is the development with regards to the reform on the deposit guarantee schemes by the European Banking Authority (EBA). EBA published the final guidelines at the end of May on calculating method for deposit insurance contributions. Under the guideline, the calculation methods will include consideration of bank’s business model, in addition to traditional indicators such as bank’s capital, liquidity, and asset quality as the risk measures. EBA said that both business model with low-earnings and unsustainable high-earnings business model should be regarded as ‘high risk’. The focus on business model by the supervisors has been the ‘trends’ in recent years. This decision by EBA suggests supervisory framework and deposit guarantee schemes have become more closely intertwined. These developments could be considered as references, should discussions regarding risk-adjusted deposit premium system arise in Japan.

As the above mentioned regulatory developments could have various impacts on the Japanese financial institutions, careful observation is critical.