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Global Risk Watch Newsletter

Temporary Lull? Before Another Storm in the Financial Market, etc.

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2.Overview of Development in Financial Regulations (Trends & Topics)

 # The Final Phase? Framework to Resolve "Too Big to Fail" (Koichi Iwai, Senior Manager, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

Regulatory reforms against "Too Big to Fail (TBTF)" have reached the final stage. Financial Stability Board (FSB) published a series of regulatory documents regarding the insolvency proceedings of global systemically important banks (G-SIBs) and insisted that they could erase the TBTF problem once and for all. The paper published this time included their final principles on the loss-absorbing capacity (Total-Loss-Absorbing Capacity, TLAC), as well as principles for the cross-border effective resolution, guidance on information sharing among regulatory authorities regarding global systemically important institutions (G-SIFIs), consultation papers on temporary funding needed to support the orderly resolution of G-SIBs and arrangements to support operational continuity in resolution.

Among all of the measures above, FSB has particularly focused on the TLAC requirements as a means to resolve TBTF problem. In this final document, G-SIBs are set to comply with TLAC requirements; (1) to hold TLAC of at least 16% of risk-weighted assets (RWA) and at least 6% of Basel III leverage ratio from the beginning of January 2019,

(2) to maintain minimum TLAC of at least 16% RWA, and 6.75% Basel III leverage ratio denominator by January 2022. These quantitative thresholds fall within the range indicated in the 2014 consultation paper. Therefore, the impact (additional capital/debt that needs to be raised) on G-SIBs also fall within industry's expectations. In addition, this FSB's final TLAC standard also permits to adopt the use of funds that have been set aside in time of recapitalization for G-SIBs. Japanese deposit insurance regime is likely to be utilized as such fund, therefore, the impact of TLAC requirements on Japanese G-SIB (three megabanks) is said to be limited.

At a glance, these global-based countermeasures against TFTB problem seem to have reached at the final phase, but it is premature to say that TBTF problems can be eliminated once and for all or the impacts of TLAC are to be limited. First, we could not say with certainty that G-SIB can be orderly resolved. While a variety of regulatory measures including TLAC requirement have been institutionalized for the past several years, it is still uncertain whether these regulatory frameworks will work as intended. This is the reason why FSB has also published guidances on short-term funding and operational continuity in order to secure sufficient liquidity as well as continuity of critical services in G-SIB resolution. Therefore, for the purpose to end the TBTF problem, it is still necessary to confirm that financial institutions would adjust their organizational structures and contract arrangements. In addition, resolution frameworks for non-bank-financial sectors must be credible, and speedy information sharing among regulatory authorities regarding cross-border resolution should be attained.

Secondly, FSB's TLAC requirement is only the minimal global standards. In fact, the US Federal Reserve Board (FRB) also published consultation papers a few days prior to FSB's publication, and stated stringent TLAC requirements. Consequently, to capture the impacts of TLAC on each G-SIB, financial sector and the financial market as a whole, we need to closely watch (1) how each country set its own TLAC requirements and (2) how resolution mechanism will work from global perspectives.

In order to evaluate whether TBTF problems has been resolved, we need to be careful about the coming actions taken by each jurisdiction and financial institutions.