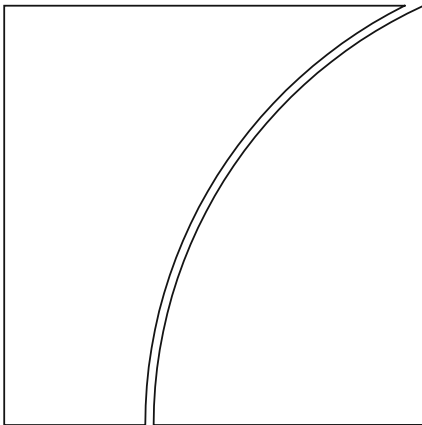


# Basel Committee on Banking Supervision



## Regulatory Consistency Assessment Programme (RCAP)

### Assessment of Basel III LCR regulations – Japan

December 2016



**BANK FOR INTERNATIONAL SETTLEMENTS**

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## Glossary

ALA	Alternative Liquidity Approaches
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
C	Compliant (grade)
D-SIB	Domestic systemically important bank
EUR	Euro
FAQ	Frequently asked question
FSA	Financial Services Agency
G-SIB	Global systemically important bank
IMM	Internal model method
JPY	Japanese yen
HQLA	High-quality liquid assets
LC	Largely compliant (grade)
LCR	Liquidity Coverage Ratio
MNC	Materially non-compliant (grade)
NA	Not applicable
NC	Non-compliant (grade)
RCAP	Regulatory Consistency Assessment Programme
RCLF	Restricted contractual committed liquidity facilities
RWA	Risk-weighted assets
SIG	Supervision and Implementation Group
SME	Small and medium-sized entities

## Preface

The Basel Committee on Banking Supervision (Basel Committee) sets a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented appropriately and consistently by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel framework.

This report presents the findings of the RCAP Assessment Team on the domestic adoption of the Basel Liquidity Coverage Ratio (LCR) standard in Japan and its consistency with the minimum requirements of the Basel III framework. The assessment focuses on the adoption of Basel standards applied to the Japanese banks that are internationally active and of significance to domestic financial stability.

The RCAP Assessment Team was led by Mr Luigi Federico Signorini, Deputy Governor of the Bank of Italy. The Assessment Team comprised three technical experts drawn from Denmark, Malaysia and the United States (Annex 1). The main counterparties for the assessment were the Japanese Financial Services Agency (FSA) and the Bank of Japan. The overall work was coordinated by the Basel Committee Secretariat with support from staff from the Bank of Italy.

The focus of the assessment was on the consistency and completeness of the Japanese regulations with the Basel minimum requirements. Issues relating to prudential outcomes, the liquidity position of individual banks or the FSA's supervisory effectiveness were not in the scope of this RCAP assessment exercise. The assessment relied upon the data, information and materiality computations provided by the FSA and the Bank of Japan by 30 September 2016. The assessment findings are based primarily on an understanding of the current processes in Japan as explained by the Japanese authorities' staff and the expert view of the Assessment Team on the documents and data reviewed.

The assessment began in March 2016 and consisted of three phases: (i) completion of an RCAP questionnaire (a self-assessment) by the Japanese authorities; (ii) an assessment phase (May to September 2016); and (iii) a post-assessment review phase (October to November 2016). The second phase included an on-site assessment, which involved discussions with the FSA, Bank of Japan, representatives of Japanese banks and representatives of audit firms. These exchanges provided the Assessment Team with a deeper understanding of the implementation of the Basel LCR in Japan. The third phase consisted of a two-stage technical review of the assessment findings: first, by a separate RCAP Review Team and feedback from the Basel Committee's Supervision and Implementation Group (SIG); and second, by the RCAP Peer Review Board and the Basel Committee. This two-step review process is a key part of the RCAP process, ensuring quality control and the integrity of the assessment findings.

Where domestic regulations and provisions were found to be non-compliant with the Basel framework, those deviations were evaluated for their current and potential impact (or non-impact) on the reported LCRs of a sample of Japanese banks. Some findings were evaluated on a qualitative basis. The assessment outcome was based on the materiality of findings and use of expert judgment.

The report has three sections and a set of annexes: (i) an executive summary with a statement from the Japanese authorities on the material findings; (ii) the context, scope and methodology, and the main set of assessment findings; and (iii) details of the deviations and their materiality along with other assessment-related observations.

The RCAP Assessment Team acknowledges the professional cooperation received from the FSA and Bank of Japan throughout the assessment process. In particular, the team sincerely thanks the staff of the Japanese authorities for playing an instrumental role in coordinating the assessment exercise. The series of comprehensive briefings and clarifications provided by the FSA and the Bank of Japan helped the RCAP assessors to arrive at their expert assessment. The Assessment Team would also like to thank the representatives of Japanese banks that provided data and information. The Assessment Team is hopeful that the RCAP assessment exercise will contribute to the sound initiatives that have been undertaken by

the FSA and Bank of Japan and to strengthening further the prudential effectiveness and full implementation of the LCR in Japan.

## Executive summary

The Japanese framework for LCR requirements was issued in October 2014 and February 2015 through the publication of two FSA Administrative Notices (the LCR Pillar 1 Notice and the LCR Pillar 3 Notice). The requirements came into effect in March and June 2015 respectively. The LCR applies to all internationally active banks in Japan.

Overall, as of 30 September 2016 (the cut-off date for the RCAP assessment), the LCR regulations in Japan are assessed as compliant with the Basel LCR standards. This is the highest grade. All components of the LCR framework, the definition of high-quality liquid assets (HQLA), liquidity outflows, liquidity inflows and disclosure requirements, are also assessed as compliant. The Assessment Team compliments the FSA for their implementation of and alignment with the Basel LCR framework.

In addition to the formal assessment of the LCR standard and disclosure requirements, this report contains annexes that summarise Japan's implementation of the LCR monitoring tools and the Basel Committee's Principles for sound liquidity risk management (see Annexes 8 and 9). Further, a summary is provided of the key national discretions and approaches that the FSA has adopted in their implementation of the LCR standard (Annex 11). These annexes show how national authorities implement certain aspects of the Basel standards that are not in scope of the formal RCAP-LCR assessment. Over time, the information detailed in these annexes will provide a basis for designing best practices and additional supervisory guidance that will benefit the regulatory community and the banking industry to raise the consistency of LCR implementation and to improve the ratio's effectiveness in practice.



## Response from the Japanese authorities

The Japanese authorities express our sincere gratitude to Mr. Luigi Federico Signorini and the Assessment Team for their professional work through the whole process of the Japanese RCAP-LCR. We also appreciate the detailed review by the Review Team.

We welcome the team's overall evaluation that the LCR framework in Japan is compliant with the Basel LCR framework. We have made our utmost efforts for the timely and proper incorporation of the LCR framework into relevant Japanese regulations, and we believe that the effective implementation of LCR has contributed to ensuring more robust liquidity risk management and supervision.

We believe that the RCAP is a very useful and important instrument to ensure consistency and transparency among cross-jurisdictional regulatory frameworks. We also support and express our willingness to participate in future assessments.

# 1 Assessment context and main findings

## 1.1 Context

### Status of implementation

The FSA is the main regulatory and supervisory authority for banks in Japan. In October 2014, the FSA issued an Administrative Notice on Liquidity Coverage Ratio for internationally active banks pursuant to the provision of Article 14-2 of the Banking Act (hereafter, the “LCR Pillar 1 Notice”). In February 2015, the FSA issued an Administrative Notice on the disclosure of Liquidity Coverage Ratio for internationally active banks pursuant to the provision of Article 19-2, paragraph (1), item (v), sub-item (e) of the Ordinance for Enforcement of the Banking Act (hereafter, the “LCR Pillar 3 Notice”). The LCR Pillar 1 Notice took effect on 31 March 2015 and the LCR Pillar 3 Notice on 30 June 2015. These regulations apply to all internationally active banks, including bank holding companies, credit cooperatives and final designated parent companies that have one or more foreign branches or subsidiaries.<sup>1</sup> They are complemented by FSA Supervisory Guidelines, Inspection Manuals and Q&As, which address more detailed points of interpretation. For more detail on the legislation issued, see Annex 2.

The Japanese authorities have implemented the LCR in line with the transitional arrangements stipulated in the Basel LCR standard. A minimum LCR of 60% applied in 2015, increasing to 100% from 2019.

The Basel standard allows jurisdictions that have a structural shortfall in HQLA to implement Alternative Liquidity Approaches (ALA). At the time of the assessment, the Japanese authorities have not implemented ALA.

### Structure of the banking sector

As of end-March 2016, there are 123 banks in Japan, of which 19 are internationally active. Total banking assets are over 600% of Japan’s gross domestic product. The banking system is mature and comprises a broad range of institutions.

In Japan, the Basel liquidity framework applies only to the 19 internationally active banks. These comprise around 65% of the risk-weighted assets (RWA) of the Japanese banking system. Internationally active banks are defined as banks that have one or more branches or subsidiaries outside Japan. The FSA does not apply the Basel LCR standards to non-internationally active banks, although it does collect information on LCRs or other related information so that it can monitor these banks’ liquidity positions. For example, the FSA collects information on LCRs from large non-internationally active banks, and it also collects information on funding concentrations and a simplified LCR from smaller non-internationally active banks.

In evaluating the materiality of its findings, the RCAP Assessment Team focused on seven entities that have been designated as either a global systemically important bank (G-SIB) or a domestic systemically important bank (D-SIB) in Japan. There are three Japanese G-SIBs and four Japanese D-SIBs (of which two are banks and two are securities firms). These seven banks comprise about 90% of the assets of Japanese internationally active banks (see Annex 7).

### Regulatory system and model of supervision

As noted above, the FSA is the main regulatory and supervisory authority for banks in Japan. It was established in 1998 as an administrative organ of the Prime Minister’s Office, responsible for the inspection

<sup>1</sup> The latter category, final designated parent companies, includes investment banks such as Nomura or Daiwa, which are securities firms rather than banks.

and supervision of private sector financial institutions and surveillance of securities transactions. In January 2001, the FSA became an external organ of the Cabinet Office and took over responsibility for resolving failed financial institutions. The FSA is now responsible for ensuring the stability of the financial system; protection of depositors, insurance policyholders and securities investors; smooth intermediation, through such measures as planning and policymaking concerning the financial industry and market; and inspection and supervision of private sector financial institutions.<sup>2</sup> As the supervisory authority, the FSA is entitled to take action should a bank have a liquidity shortfall or otherwise not meet its standards for liquidity risk management.

The Bank of Japan carries out monetary policy and is responsible for financial stability and the effective settlement of financial transactions. It conducts on-site examinations and off-site monitoring of its counterparty financial institutions, in the context of its central banking functions. This includes the large Japanese banks. Its supervisory powers are grounded on individual contracts with its counterparties, based on Article 44 of the Bank of Japan Act.

In addition to the supervision of minimum liquidity requirements, the FSA monitors the banks' liquidity buffers using the Basel liquidity monitoring tools, as well as additional reporting templates in major currencies. The FSA has not implemented the Basel guidance on monitoring tools for intraday liquidity management, but the Bank of Japan closely monitors banks' intraday liquidity positions. This monitoring is explained in more detail in Annex 8. The quality of the banks' liquidity risk management is also assessed against the principles for sound liquidity risk management and involves both on-site and off-site assessments (Annex 9).

## 1.2 Structure, enforceability and binding nature of prudential regulations

The FSA's supervisory practice is governed by the Banking Act, which provides for FSA independence in day-to-day bank supervision. Under the Banking Act, the FSA may issue FSA Notices. The FSA also issues Q&A, Supervisory Guidelines and Inspection Manuals. Regulation constitutes fully binding formal rules. Although the other documents are less formal in nature, they are publicly available and banks are expected to comply with them. As in the previous assessment of the implementation of the Basel risk-based capital standards in Japan,<sup>3</sup> the Assessment Team finds that the LCR regulations in Japan meet the RCAP criteria of being enforceable and binding in practice (see also Annex 5).

<sup>2</sup> The Securities and Exchange Surveillance Commission, responsible for market surveillance and inspections of securities companies, and the Certified Public Accountants and Auditing Oversight Board, responsible for overseeing quality review work performed by the Japanese Institute of Certified Public Accountants, are also within the FSA, although they have different powers to those used for bank regulation and supervision.

<sup>3</sup> Basel Committee on Banking Supervision, *Basel III regulatory consistency assessment (Level 2): Japan*, October 2012, [www.bis.org/bcbs/implementation/l2\\_jp.pdf](http://www.bis.org/bcbs/implementation/l2_jp.pdf).

## Structure of Japanese laws and regulatory instruments

Table 1

Laws that empower the FSA as banking supervisor	Banking Act (Act No. 59 of June 1, 1981), enacted by the Diet
Supervisory regulatory instruments issued by the FSA derived from the above law	FSA Notices
	Q&A give detailed interpretation of FSA Notices.
	Supervisory Guidelines are meant for FSA staff and are the basis for the conduct of FSA supervision. However, they are also public documents that banks are expected to comply with. Banks are consulted on the establishment of the guidelines and any amendments. The FSA may take formal action in a case of non-compliance with Supervisory Guidelines.
	Inspection Manuals are manuals for FSA staff and also guide banks in the development of their internal management. Banks are consulted when manuals are established or amended and are expected to change their practices if inspections reveal that they are not following the practices set out in the manuals.

### 1.3 Scope of the assessment

The assessment was made of the LCR requirements as applicable to internationally active banks in Japan (henceforth, “banks”), as of 30 September 2016. The assessment had two dimensions:

- a comparison of domestic regulations with the Basel LCR standards to ascertain that all the required provisions have been adopted (*completeness* of the Japanese domestic regulation); and
- whether there are any differences in substance between the domestic regulations and the Basel LCR standards and their significance (*consistency* of the Japanese regulation).

In its assessment, the RCAP Assessment Team considered all binding documents that effectively implement the Basel LCR framework in Japan. Importantly, the assessment did not evaluate the adequacy of liquidity or resilience of the banking system in Japan or the supervisory effectiveness of the Japanese authorities.

#### Assessment grading and methodology

As per the RCAP methodology approved by the Basel Committee, the outcome of the assessment was summarised using a four-grade scale, both at the level of each of the four key components of the Basel framework for the LCR and overall assessment of compliance: compliant, largely compliant, materially non-compliant and non-compliant.<sup>4</sup>

The materiality of the deviations was assessed in terms of their current or, where applicable, potential future impact (or non-impact) on banks’ LCRs. The quantification was, however, limited to the agreed sample of banks. Wherever relevant and feasible, the Assessment Team, together with Japanese authorities, attempted to quantify the impact based on data collected from Japanese banks in the agreed sample of banks (see Annex 7). In addition to the available data, the assessment relied on expert judgment as to whether the domestic regulations met the Basel framework in letter and in spirit. The non-quantifiable aspects of identified deviations were discussed and reviewed in the context of the prevailing regulatory practices and processes with the Japanese authorities.

<sup>4</sup> This four-grade scale is consistent with the approach used for assessing countries’ compliance with the Basel Committee’s *Core principles for effective banking supervision*. The actual definition of the four grades has been adjusted to take into account the different nature of the two exercises. In addition, components of the Basel framework that are not relevant to an individual jurisdiction may be assessed as not applicable (NA). See [www.bis.org/publ/bcbs264.htm](http://www.bis.org/publ/bcbs264.htm) for further details.

Ultimately, the assignment of the assessment grades was guided by the collective expert judgment of the Assessment Team. In doing so, the Assessment Team relied on the general principle that the burden of proof rests with the assessed jurisdiction to show that a finding is not material or not potentially material. A summary of the materiality analysis is given in Section 2 and Annex 7.

In a number of areas, the Japanese rules go beyond the minimum Basel standards. Although these elements provide for a more rigorous implementation of the Basel framework in some aspects, they have not been taken into account for the assessment of compliance under the RCAP methodology as per the agreed assessment methodology (see Annex 10 for areas of super-equivalence).

## 1.4 Main findings

Overall, the Assessment Team finds the Japanese LCR requirements to be compliant with the Basel standard.

Summary of assessment grades		Table 2
Key components of the Basel LCR framework	Grade	
Overall grade	C	
Definition of high-quality liquid assets (numerator)	C	
Definition of net outflows (denominator)	C	
Definition of net inflows (denominator)	C	
LCR disclosure requirements	C	

Compliance assessment scale (see Section 1.3 for more information on the definition of the grades): C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

### Main findings by component

#### *High-quality liquid assets (numerator)*

The principles regarding the HQLA under the Japanese rules are compliant with the Basel standards. The Assessment Team identified two findings, neither of which is considered material.

The first finding is that the Japanese framework contains no requirements on the management of intraday liquidity risk. However, the Assessment Team viewed this as not material as there is a periodic reporting requirement for monitoring purposes by the Bank of Japan on the intraday liquidity risk of Japanese banks. The second finding is on the requirement to diversify the stock of HQLA across asset classes. The Japanese authorities do not include this requirement. However, the Assessment Team does not view this as material, as Level 1 HQLA comprise 96% of the total HQLA of internationally active banks in Japan. According to the FSA, this has been stable since 2013.

#### *Outflows (denominator)*

The Japanese rules regarding the liquidity outflows are compliant with the Basel standards.

The Assessment Team found two deviations from the Basel framework. One related to exposures arising from prime brokerage services. The Basel standards set out specific rules arising from prime brokerage customer cash balances, which have not been implemented in Japan. However, this difference is not material, because prime brokerage is not a significant business for Japanese banks.

The other finding related to an alternative approach that the Japanese authorities have developed for calculating the liquidity needs arising from market valuation changes on derivatives. However, as no bank currently uses this approach nor is planning to do so in the near term, this finding is also not considered material.

### *Inflows (denominator)*

The Japanese rules on liquidity inflows are compliant with the Basel III standards.

The Assessment Team identified one deviation from the Basel rules, that the FSA does not currently monitor the concentration of expected inflows across counterparties. Although this finding does not have a direct impact on the LCR calculation, it can nonetheless affect liquidity risk. The current structure of Japanese banks' balance sheets does not indicate a material dependence on inflows, and measures are in place requiring banks to monitor and limit counterparty concentration. The finding is therefore considered non-material. The Assessment Team would, however, like to emphasise the importance of banks and the FSA monitoring inflows so that concentrations do not develop in the future.

### *Disclosure requirements*

The Japanese disclosure requirements are compliant with the Basel LCR disclosure requirements. Only one finding has been identified, regarding the requirement to include qualitative disclosures on the concentration of banks' funding sources. The Assessment Team does not consider this finding to be material, because the concentration of funding sources is not significant among Japanese banks. According to FSA data, the top 10 counterparties for unsecured funding comprised less than 10% of the total unsecured funding in Japanese banks.

## 2 Detailed assessment findings

The component-by-component details of the assessment of compliance with the LCR in the Basel framework are detailed below. The focus of Sections 2.1 and 2.2 is on findings that were assessed to be deviating from the Basel minimum standards and their materiality. Section 2.3 lists some observations and other findings specific to the implementation practices in Japan.

### 2.1 LCR

#### 2.1.1 High-quality liquid assets (numerator)

Section grade	Compliant
Summary	The Japanese implementation of the HQLA standard follows the Basel standard with two non-material exceptions.
Basel paragraph number	41
Reference in domestic regulation	n/a
Findings	<p>The Basel framework expects banks to manage actively intraday liquidity positions and risks. The Japanese framework does not contain any requirements on intraday liquidity risk.</p> <p>However, there is a periodic reporting requirement for monitoring purposes by the Bank of Japan on the intraday liquidity risk of Japanese banks. The Bank of Japan receives reports each day from all counterparty institutions (including all internationally active banks). The provision of these reports is considered an essential part of the Bank of Japan's liquidity supervision, the powers for which are grounded in individual contracts with its counterparties based on Article 44 of the Bank of Japan Act. Banks not providing the reports may trigger formal sanctions by the Bank of Japan, including suspension or termination of a bank's current account.</p> <p>Thus, this finding is not considered material.</p>
Materiality	Not material
Basel paragraph number	44
Reference in domestic regulation	n/a
Findings	<p>The Basel framework requires the stock of HQLA to be well diversified across asset classes.</p> <p>The Japanese authorities do not include this requirement, because they believe that the desired level of diversification is different across banks depending on their risk profile.</p> <p>According to the FSA, Level 1 HQLA comprised 96% of total HQLA of internationally active banks in Japan. Therefore, the Assessment Team does not consider this finding to be material.</p>
Materiality	Not material

#### 2.1.2 Outflows (denominator)

Section grade	Compliant
Summary	<p>The Assessment Team found two deviations from the Basel standards on LCR outflows. The first deviation relates to the treatment of customer cash balances arising from prime brokerage services. However, as prime brokerage business is not significant among Japanese institutions, this is not viewed as a material deviation currently. The second deviation relates to the calculation of increased liquidity needs arising from market valuation changes on derivatives portfolios. The FSA have implemented an alternative method to estimate these liquidity needs in addition to the method</p>

	described in the Basel framework. The FSA believes that the alternative method is more risk-sensitive than the simple method in the Basel framework. However, in some cases, the alternative method will be less conservative than the Basel method. As no institutions currently use the alternative method, this is not currently viewed to be a material deviation.
Basel paragraph number	111
Reference in domestic regulation	Q&A Article 3-Q6
Findings	<p>The Basel framework requires customer cash balances arising from the provision of prime brokerage services to be considered separately from any required segregated balances related to client protection regimes imposed by national regulations. Also, such balances should not be netted against other customer exposures.</p> <p>The Japanese regulations do not specify a treatment for customer cash balances arising from the provision of prime brokerage.</p> <p>Currently, only one Japanese institution is active in the prime brokerage business. This is a very limited portion of their business model. On this basis, the deviation is not currently viewed as material and is unlikely to become material over the coming years.</p>
Materiality	Not material
Basel paragraph no	123
Reference in domestic regulation	LCR Pillar 1 Notice Article 38 and 39 Supervisory Guidelines III-2-3-4-4-2-2
Findings	<p>The Basel framework imposes additional requirements to reflect the increased liquidity needs related to market valuation changes on derivative or other transactions. This is calculated based on historical positions during the preceding 24 months. The Basel framework notes that the treatment may be adjusted by supervisors based on circumstances.</p> <p>The FSA has implemented the historical look-back approach of the Basel framework, but has also implemented an alternative approach. This is a forward-looking approach, based on the Internal Model Method (IMM) in the counterparty credit risk framework. It uses simulation techniques to predict future derivatives exposure and so is more risk-sensitive than the Basel framework. It is designed for sophisticated banks with large derivatives positions. Banks may only use this approach once the FSA has reviewed and approved the relevant internal models.</p> <p>This alternative approach may be more or less conservative than the historical method set out in the Basel framework, dependent on the development of an individual institution's derivatives exposures and stress events over time. The scenario approach requires banks to calibrate the parameters based on stress events back to 2007 when determining the additional collateral outflow, rather than just the last two years as is the case in the Basel method. This aspect is at least as conservative as the historical look-back approach. However, as the scenario approach looks at current derivative exposures when calculating additional collateral needs, the scenario approach will be less conservative than the Basel method in cases where an institution has decreased its derivative position compared to the exposure under the historical look-back approach.</p> <p>Currently, no banks use the alternative approach. The FSA views it unlikely that any banks will be able to use the scenario approach over the coming years.</p> <p>The Assessment Team believes that the implementation of an alternative approach to that defined in the Basel framework is a deviation that goes further than the option in the Basel framework to adjust the stated approach based on circumstances. The Assessment Team recognises that the scenario approach implemented by the FSA is more risk-sensitive than the historical look-back approach of the Basel framework and that, in some cases, the scenario approach may be more conservative (as it looks at a longer time period to identify stressed outflows than the two-year period of the historical look-back approach). However, there are also likely to be cases where the scenario approach will be less conservative than the Basel framework.</p> <p>As the scenario approach is not currently used by any Japanese institutions and is unlikely to be used in the coming years, the deviation is not currently viewed as material.</p>



Materiality	Not material
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### 2.1.3 Inflows (denominator)

Section grade	Compliant
Summary	The Assessment Team found one deviation from the Basel LCR standard. This deviation relates to the monitoring of concentration of expected inflows across counterparties. The FSA views the current composition of institutions' inflows as being focused on inflow categories that do not result in counterparty concentration. The FSA requires banks to monitor inflows and manage risks associated with concentration hereof, as well as requiring exposure limits to be set on a counterparty level. The Assessment Team considered that the deviation is non-material, but emphasises the importance of focusing on any developments leading to higher inflow dependencies in the institutions' LCR.
Basel paragraph number	143
Reference in domestic regulation	n/a
Findings	<p>The Basel standard requires supervisors to monitor the concentration of expected inflows across counterparties. The FSA has not implemented this requirement.</p> <p>The FSA believes the deviation not to be material currently, due to the composition of institutions' inflows.</p> <p>The Assessment Team agrees that the deviation is not material at this stage, given the current structure of institutions' balance sheets. The FSA requires institutions to monitor large-lot transactions, including inflows, and manage the risk related hereto. The FSA also requires institutions to set exposure limits, including limits on a counterparty level. This limits the risk that an inflow concentration in institutions' LCR will occur in the near future.</p> <p>The Assessment Team would however like to emphasise the need for banks to monitor the evolution of their LCR inflows, so as to ensure that a concentration of inflows does not develop in the future and pose a risk to institutions' ability to comply with the LCR. The Assessment Team also views it as important that the FSA monitors developments. This deviation does not affect the calculation of the LCR.</p>
Materiality	Not material

## 2.2 LCR disclosure requirements

Section grade	Compliant
Summary	Japan has implemented the Basel LCR disclosure standards with one deviation related to the requirement to discuss the concentration of funding sources in qualitative disclosure requirements. This is not considered material.
Basel paragraph number	15
Reference in domestic regulation	n/a
Findings	<p>The Basel framework requires banks to publish qualitative information on their liquidity risk position. The standard is not prescriptive, but gives several examples of factors that may be relevant to a bank's liquidity position. Banks must provide information on all factors relevant for their position.</p> <p>The Japanese regulations require qualitative disclosure on all the examples cited in the Basel standards, apart from the concentration of funding sources.</p> <p>As the concentration of funding sources is not significant among Japanese banks, the Assessment Team considered this as not material. According to the FSA, the top 10</p>

	counterparties for unsecured funding comprised less than 10% of the total unsecured funding in Japanese banks.
Materiality	Not material

## 2.3 Observations and other findings specific to the implementation practices in Japan

The following observations highlight special features of the regulatory implementation of the Basel LCR standards in Japan. These are presented for contextual and informational purposes. Observations are considered compliant with the Basel standard and do not have a bearing on the assessment outcome.

### 2.3.1 High-quality liquid assets (numerator)

Basel paragraph number	21
Reference in domestic regulation	Inspection manual, Checklist for Liquidity Risk Management, II-2-1-(3)-(ii) and II-2-4-3 and 4
Observation	The Basel framework requires banks to conduct internal stress tests to assess the level of liquidity buffer that they should hold beyond the minimum LCR requirement. In Japan, this requirement applies to large and complex financial groups. However, other banks are only required to conduct an impact evaluation under two or more scenarios, which is not linked directly to the LCR and the requirement to maintain a liquidity buffer in excess of the minimum LCR requirement.

## Annexes

### Annex 1: RCAP Assessment Team and Review Team

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## Annex 2: Local regulations issued by Japanese authorities for implementing Basel LCR standards

Overview of issuance dates of important Japanese liquidity regulations

Table A.1

Domestic regulations	Name of the document, version and date
FSA Notices	FSA Administrative Notice on the Liquidity Coverage Ratio of internationally active banks pursuant to the provision of Article 14-2 of the Banking Act (LCR Pillar 1 Notice), October 2014 FSA Administrative Notice on the disclosure of liquidity coverage ratio for internationally active banks pursuant to the provision of Article 19-2, paragraph (1), item (v), sub-item (e) of the Ordinance for Enforcement of the Banking Act (LCR Pillar 3 Notice), February 2015
Q&A	Q&A Concerning Liquidity Regulation, December 2014
Supervisory Guidelines	Supervisory Guidelines for Major Banks, amended in March 2015
Inspection Manuals	Checklist for Liquidity Risk Management amended in March 2015

Hierarchy of Japanese laws and regulatory instruments

Table A.2

Level of rules (in legal terms)	Type
Law	Law enacted by Parliament
FSA Notice	Regulations made by the FSA
Q&A	Technical or implementation guidelines on FSA Notices, issued by the FSA
Supervisory Guidelines and Inspection Manuals	Guidelines and manuals for FSA supervision, made by the FSA and which banks are expected to follow

## Annex 3: List of LCR standards under the Basel framework used for the assessment

### *Basel documents in scope of the assessment*

- *The Liquidity Coverage Ratio* (January 2013), including the *Frequently asked questions on Basel III's January 2013 Liquidity Coverage Ratio* (April 2014)
- *Liquidity Coverage Ratio disclosure standards* (January 2014)

### *Basel documents reviewed for information purposes*

- *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (January 2013) (part of liquidity risk monitoring tools)
- *Monitoring tools for intraday liquidity management* (April 2013)
- *Principles for sound liquidity risk management and supervision* (September 2008)

## Annex 4: Details of the RCAP assessment process

### *Off-site evaluation*

- Completion of a self-assessment questionnaire by the Japanese authorities
- Evaluation of the self-assessment by the RCAP Assessment Team
- Independent comparison and evaluation of the domestic regulations issued by the Japanese authorities with corresponding Basel standards issued by the BCBS
- Identification of observations
- Refinement of the list of observations based on clarifications provided by the Japanese authorities
- Assessment of materiality of deviations for all quantifiable deviations based on data and non-quantifiable deviations based on expert judgment
- Forwarding of the list of observations to the Japanese authorities

### *On-site assessment*

- Discussion of individual observations with the Japanese authorities
- Meeting with selected Japanese banks and audit firms
- Discussion with the Japanese authorities and revision of findings to reflect additional information received
- Assignment of component grades and overall grade
- Submission of the detailed findings to the Japanese authorities with grades
- Receipt of comments on the detailed findings from the Japanese authorities

### *Review and finalisation of the RCAP report*

- Review of comments by the RCAP Assessment Team, finalisation of the draft report and forwarding to the Japanese authorities for comments
- Review of the Japanese authorities' comments by the RCAP Assessment Team
- Review of the draft report by the RCAP Review Team
- Reporting of findings to the SIG by the Team Leader
- Review of the draft report by the Peer Review Board
- Approval of the report by the Basel Committee and publication

## Annex 5: Assessment of the bindingness of regulatory documents

The following table summarises the assessment of the seven criteria used by the Assessment Team to determine the eligibility of Japanese regulatory documents. The Assessment Team concluded that the regulatory instruments issued and used by the FSA as set out in Annex 2 are eligible for the RCAP assessment.

Criterion	Assessment
(1) The instruments used are part of a well defined, clear and transparent hierarchy of legal and regulatory framework.	The Japanese legal and regulatory framework for banks forms a clear and transparent hierarchy under the Banking Act. Under the Banking Act, there are delegated legislations, such as cabinet orders, ministerial orders and FSA notices. With regard to liquidity requirements, the rules are stipulated in the Pillar 1 and Pillar 3 Notices. Furthermore, Supervisory Guidelines complement those delegated legislations, and Frequently Asked Questions about the Capital Adequacy Requirements ("Q&As") provide detailed interpretations of the Pillar 1 Notice.
(2) They are public and easily accessible	The Banking Act, the Pillar 1 and Pillar 3 Notices, Supervisory Guidelines and Q&As are published in final form on the FSA's website.
(3) They are properly communicated and viewed as binding by banks as well as by the supervisors.	The Banking Act and the Pillar 1 and Pillar 3 Notices are binding for banks as well as authorities. Based on the Banking Act, the FSA may issue business improvement orders. As for the Supervisory Guidelines, they are published so that banks are expected to appropriately manage their business based on the guidelines and supervision is conducted based on the guidelines, and where necessary, the FSA takes necessary steps using its legislative powers. In other words, if banks breached, violated or ignored the Supervisory Guidelines, the FSA takes necessary action, such as issuing business improvement orders. With regard to Q&As, any breaches, violations or ignorance of them may also incur action by the FSA. Through these measures, Supervisory Guidelines and Q&As are also viewed as binding by banks.
(4) They would generally be expected to be legally upheld if challenged and are supported by precedent.	Since the Pillar 1/Pillar 3 Notices, Supervisory Guidelines and Q&A issued by the FSA are based on the authority delegated by the Banking Act, they would be expected to be legally upheld if challenged. Enforcement actions by FSA have never been challenged in court.
(5) Consequences of failure to comply are properly understood and carry the same practical effect as for the primary law or regulation.	Any breaches or violations of any banking regulations including liquidity-related requirements are subject to corrective measures. The FSA has the power at its discretion to issue business improvement orders to require banks to take remedial actions. The aforementioned is properly understood by banks.
(6) The regulatory provisions are expressed in clear language that complies with the Basel provisions in both substance and spirit.	All legislation and regulatory instruments are written in clear language that complies with the Basel provisions in both substance and spirit.
(7) The substance of the instrument is expected to remain in force for the foreseeable future	The regulatory instruments are amended from time to time so that they are kept up to date according to the changes in relevant international standards. As such, they are expected to remain in force for the foreseeable future.

## Annex 6: Key liquidity indicators of the Japanese banking system

Overview of Japanese banking sector liquidity as of end-March 2016

Table A.3

Size of banking sector (JPY, millions)			
Total assets all banks operating in the jurisdiction (including off-balance sheet assets)	3,358,083,618		
Total assets of all locally incorporated internationally active banks	2,548,205,141		
Total assets of locally incorporated banks to which liquidity standards under the Basel framework are applied	2,548,205,141		
Number of banks			
Number of banks operating in the jurisdiction (excl. local representative offices)	123		
Number of Global Systemically Important Banks (G-SIBs)	3		
Number of Domestic Systemically Important Banks (D-SIBs)	4		
Number of banks which are internationally active banks	19		
Number of banks required to implement Basel III liquidity standards	19		
Number of banks required to implement domestic liquidity standards	123		
Breakdown of LCR for seven RCAP sample banks (JPY, millions)		Unweighted	Weighted
Total HQLA	251,936,556	245,637,922	
Level 1 HQLA	236,533,365	236,533,365	
Level 2A HQLA	4,008,465	3,407,194	
Level 2B HQLA	11,394,725	5,697,363	
ALA HQLA	-	-	
<b>Total cash outflows</b>	<b>879,578,396</b>	<b>221,159,622</b>	
Retail and small business stable deposits	55,984,087	1,380,130	
Retail and small business less stable deposits	137,619,061	13,809,404	
Wholesale unsecured operational deposits	1,726,961	431,740	
Wholesale unsecured non-operational funding	247,171,504	153,296,626	
Secured funding	100,449,397	5,362,307	
Debt issued instruments (incl. credit and liquidity facilities)	87,614,258	20,371,195	
Other contractual outflows	9,020,515	4,153,343	
Contingent funding obligations	239,992,613	22,354,877	
<b>Total cash inflows</b>	<b>126,705,485</b>	<b>41,273,304</b>	
Secured lending	61,447,006	5,050,595	
Fully performing unsecured loans	40,142,417	27,222,458	
Other cash inflows	25,116,062	9,000,251	
<b>Liquidity Coverage Ratio (%)</b>		<b>167%</b>	



## Annex 7: Materiality assessment

The outcome of the RCAP assessment is based on the materiality of the findings. As a general principle, and mirroring the established RCAP assessment methodology for risk-based capital standards, a distinction is made between quantifiable and non-quantifiable findings. The RCAP-LCR materiality assessment is based on both quantitative and qualitative information with an overlay of expert judgment. Where possible, teams also take into account the dynamic nature of liquidity risks and seek to assess the materiality of any deviations at different points in time.

In line with underlying RCAP principles, for quantifiable gaps the materiality assessment is based on a determination of the cumulative impact of the identified deviations on the reported LCR ratios of banks in the RCAP sample (see below). For non-quantifiable gaps, the team relies on expert judgment only. Following this approach, an attempt was made to determine whether findings are “not material”, “material” or “potentially material”. The following table summarises the number of deviations according to their materiality.

Component	Not material	Potentially material	Material
Definition of HQLA (numerator)	2	0	0
Outflows (denominator)	2	0	0
Inflows (denominator)	1	0	0
LCR disclosure requirements	1	0	0

### *RCAP sample of banks*

The following Japanese banks were selected for testing the materiality of quantifiable deviations. Together these banks represent approximately 90% of the total assets of internationally active Japanese banks.

Banking group	Share of banks' assets in the total assets of internationally active Japanese banks (%)
Mitsubishi UFJ FG	29.5
Mizuho FG	18.9
Sumitomo Mitsui FG	18.7
Norinchukin	9.8
Sumitomo Mitsui TH	5.8
Nomura HD	5.7
Daiwa HD	1.8
Total	90.1

Source: FSA. For this purpose, banking assets are based on the total exposures in the leverage ratio, which include both on- and off-balance sheet exposures.

On the basis of RWA, internationally active banks comprise 65% of the Japanese banking system. The RCAP sample banks comprise 55% of the RWA of the total Japanese banking system.

## Annex 8: Japan's implementation of the liquidity monitoring tools

### Basel liquidity monitoring tools

#### *General monitoring*

In addition to the minimum standard for the LCR, the Basel LCR framework also outlines the metrics to be used to monitor liquidity risks ("the monitoring tools"). The monitoring tools capture specific information related to a bank's cash flows, balance sheet structure, available unencumbered collateral and certain market indicators. The monitoring tools supplement the LCR standard and are a cornerstone for supervisors in assessing the liquidity risk of a bank. This annex provides a qualitative overview of the implementation of the monitoring tools in Japan.

A list of the monitoring tools prescribed in the BCBS January 2013 document and the most important corresponding monitoring tools prescribed by the FSA is given below:

No	BCBS monitoring tool	FSA's corresponding reporting template	Effective since	Frequency of submission	Deadline for submission to FSA
1	Contractual maturity mismatch	Contractual maturity mismatch	March 2015	Monthly	Within one month
2	Concentration of funding	Concentration of funding	March 2015	Monthly	Within one month
3	Available unencumbered assets	Available unencumbered assets	March 2015	Monthly	Within one month
4	LCR by significant currency	LCR by significant currency (Same format as LCR)	March 2015	Monthly	Within 10 business days

#### How are those reporting templates used by supervisors?

The Japanese authorities use these templates to analyse banks' liquidity risk. With the monitoring information, the authorities evaluate the potential risks that banks could suffer in the longer term, and initiate a dialogue with banks as necessary.

It should be noted that the Japanese requirements are stricter than the Basel agreement. As for items 1–3 above, banks are required to submit, in addition to the all-currency basis that the Basel agreement stipulates, three more formats: on a Japanese yen (JPY), US dollar and euro basis. Such information is helpful in understanding banks' foreign currency liquidity risk profiles, which has been the main focus of Japanese supervision on liquidity risk.

The FSA uses these indicators only as "monitoring tools", and it has no intention to use them as regulations that set any minimum quantitative targets.

#### Brief explanation on the implementation of liquidity risk-related reporting templates

As shown in the table above, the Japanese authorities require banks to submit the monitoring tools on a monthly basis. The LCR by significant currency (report number 4) should be reported within 10 business days after the reference date (the same timeline as the LCR template), whereas the other three metrics should be reported within one month of the reference date.

#### Basel guidance on monitoring tools for intraday liquidity management

The BCBS issued guidance on monitoring tools for intraday liquidity management in April 2013.

Although Japanese regulations have not covered this issue yet, the Bank of Japan closely monitors banks' intraday liquidity positions on a continuous basis and has daily communication with banks. It is also worth noting that Japanese banks' liquidity positions are quite strong because of the Bank of Japan's quantitative easing and banks' funding-investment structures, in which deposit inflows are larger than loan outflows.

## Annex 9: Japan's implementation of the principles of sound liquidity risk management and supervision

This annex outlines the implementation of the Basel Committee's Principles for sound liquidity risk management and supervision (Sound Principles) in Japanese regulations. The principles are not part of the formal RCAP assessment, and no grade is assigned. This annex is for information only.

The Japanese Supervisory Guidelines refer directly to Basel principles, including the Sound Principles. They stipulate that "Supervisory authorities shall make efforts to reflect the principles and the guidelines on international supervision on banks that are agreed in the Basel Committee on Banking Supervision, etc ..." (I-4.-(10)). As such, the Sound Principles are thoroughly reflected in banking supervision in Japan.

The items below are more specific stipulations in Japanese regulations that are in line with the Sound Principles.

### Fundamental principle for the management and supervision of liquidity risk – Principle 1

The first principle states the overall purpose that banks are responsible for having processes in place to actively monitor and manage liquidity risk.

The Japanese regulations are in line with Principle 1. III-2-3-4-1 of the Supervisory Guidelines, stipulating that "It is important for banks to appropriately develop an internal risk management system to manage liquidity risk."

### Governance of liquidity risk management – Principles 2–4

Sound Principles 2–4 state that banks should maintain sound governance of liquidity risk management.

As for Principle 2 (liquidity risk tolerance), the Inspection Manual covers this principle by posing questions such as: "Does the Board of Directors.....establish appropriate limits suited to the scale and nature of the institution's business and its risk profile, financial conditions and fund-raising capacity.....?" and "Does the Board of Directors ... revise the method of establishing limits and the limits established in a regular and timely manner or on an as needed basis?" (Checklist for Liquidity Risk Management I-2.-(2)).

With respect to Principle 3 (role of senior management), the Inspection Manual checklist includes questions on senior management attitudes and accountability regarding liquidity risk. Questions reviewed by supervisors include, "Do directors attach importance to liquidity risk management, fully recognising that the lack of such an approach could lead directly to bankruptcy in some cases? In particular, does the director in charge of liquidity risk management review the policy and specific measures for developing and establishing an adequate liquidity risk management system with a full understanding of the scope, types and nature of risks, and the techniques of identification, assessment, monitoring and control regarding liquidity risk as well as the importance of liquidity risk management, and with precise recognition of the current status of liquidity risk management within the financial institution based on such an understanding?" (Checklist for Liquidity Risk Management I-1.-(1)).

### Measurement and management of liquidity risk – Principles 5–12

Although Japanese regulations do not stipulate all the items described in Principles 5–12 about the measurement and management of liquidity risk, most of them are reflected in Japanese regulations. Principles 8 (on intraday liquidity management) and 10 (on stress testing) have already been discussed earlier in this report, in Sections 2.1.1 and 2.3.1, respectively.

Principle 5 (identifying, measuring, monitoring and controlling of liquidity risk) and Principle 6 (monitoring within or across legal entities etc) are covered in the Checklist for Liquidity Risk Management II-2.-(1)-(3) and (2) of the Inspection Manual respectively. Also, Principles 7 (diversification in the sources

and tenor of funding) and 11 (contingency funding plan) are reflected in the Inspection Manual, in the Checklist for Liquidity Risk Management II-2.-(1)-(3).

With respect to Principle 9 (collateral management), the Japanese authorities require banks to submit a report on "Available unencumbered assets" in line with the Basel standards. Supervisors then analyse any possible weaknesses in banks' collateral management.

As for Principle 12 (a cushion of highly liquid assets), the LCR requires banks to hold a sufficient cushion of HQLA with which they can sustain their business even in times of stress. In addition, reporting to supervisors on "Available unencumbered assets" and "Concentration of funding" helps banks and supervisors to assess possible impediments to banks' use of assets to obtain funding.

### Public disclosure – Principle 13

In Japanese regulations, the LCR Pillar 3 Notice requires banks to disclose information on liquidity risk management, including the LCR. Additionally, the Checklist for Liquidity Risk Management I-2.-(2) of the Inspection Manual requires banks to establish a sound disclosure scheme.

### The role of supervisors – Principles 14–17

Although the roles of supervisors are not described here in detail, monitoring and inspections are important tools regularly used by the Japanese authorities to perform a comprehensive assessment of a bank's overall liquidity risk management framework and liquidity position. Such actions are the essence of Principle 14 (regular assessments by supervisors). Additionally, the FSA adapts its supervisory methods so that its efforts are commensurate with banks' risk profiles, including a bank's role in the financial system (see Checklist for Liquidity Risk Management I-2.-(2) and II-2.-(3) in the Inspection Manual).

Principle 15 (use of internal reports and other information) has not been implemented directly into Japanese regulations. However, the Japanese authorities take it for granted that they will use information described in this principle in their liquidity supervision.

When Japanese authorities find deficiencies in banks' liquidity risk management processes or liquidity position, the FSA will issue a business improvement order to require banks to take effective and timely remedial action (III-2-3-4-3 of the Supervisory Guidelines), in line with Principle 16 (supervisors' intervention).

Although Principle 17 (communication with other supervisors and public authorities) is not reflected in Japanese regulation in detail, the FSA and the Bank of Japan have ongoing communication at every level. Also, the Japanese authorities communicate with foreign supervisors, including (though not only) through supervisory colleges.

## Annex 10: Areas where Japanese LCR rules are stricter than the Basel standards

In one place, the Japanese authorities have adopted a stricter approach than the minimum standards prescribed by Basel. In particular, the FSA requires banks to calculate an “approximate LCR” on a daily basis and within two days of the relevant date. The FSA does not mandate the design of the approximate LCR, but banks must cover as many components of the LCR as possible and cover at least 80% of the numerator.

Banks do not report the approximate LCR to the FSA each day, but they must report it to the FSA if it is lower than the LCR minimum plus 20% (ie when the requirement is 100% in 2019, the reporting threshold will be 120%). The FSA expects that this indicator will be used in banks’ internal risk management processes and will urge banks to monitor liquidity risk more closely and on a daily basis.

It should be noted that stricter rules have not been taken into account as mitigants for the overall assessment of compliance.

## Annex 11: Implementation of LCR elements subject to prudential judgment or discretion in Japan

The following tables provide information on elements of LCR implementation that are subject to prudential judgment and national discretion. The information provided helps the Basel Committee to identify implementation issues where clarifications and (additional) FAQs could improve the quality and consistency of implementation. It should also inform the preliminary design of any peer comparison of consistency across the membership that the Committee may decide to conduct, in similar fashion to the studies on RWA variation for the capital standards.

Elements requiring judgment (non-comprehensive list)

Table A.6

Basel paragraph	Description	Implementation by the FSA
24(f)	Treatment of the concept of “large, deep and active markets”	<p>The FSA’s LCR Pillar 1 Notice (Articles 9–11) refers to this term as a characteristic for HQLAs. The FSA considers an asset as being traded in “large, deep and active markets” if the asset has low bid-ask spreads, high trading volumes, and a large and diverse number of market participants.</p> <p>More specifically, Article 9-Q6 of the Q&amp;A gives examples of instruments that are deemed not to meet this requirement.</p> <ul style="list-style-type: none"> <li>• Securities with issue size below JPY 1 billion.</li> <li>• Securities that are sold exclusively in the retail market and are not traded between financial institutions.</li> <li>• Private placement bonds that are not traded under the same conditions as publicly offered bonds.</li> </ul>
50	Treatment of the concept of “reliable source of liquidity”	<p>The FSA’s LCR Pillar 1 Notice (Articles 9–11) has adopted this concept as an essential characteristic for HQLAs. Maximum levels of decline of price/increase in haircut for Level 2 assets during periods of significant liquidity stress are set at the same level as the Basel standard (eg 10% for Level 2A, 20% for non-equities in Level 2B and 40% for equities in Level 2B).</p>
52	Treatment of the concept of “relevant period of significant liquidity stress”	<p>The FSA considers the relevant period of significant liquidity stress as periods with similar characteristics to the 2007–08 global financial crisis. As such, Article 10-Q1 of the Q&amp;A stipulates that the observation period for price decline test should go back to 2007 at least.</p>
74–84	Retail deposits are divided into “stable” and “less stable”	<p>The FSA has divided retail deposits into “stable” and “less stable” based on the criteria prescribed by the Basel III LCR Standard.</p> <p>Stable deposit: Retail deposits that are fully covered by an effective deposit insurance scheme and satisfy any of the following requirements. The depositors have established relationships with banks and are highly unlikely to withdraw the deposits. The deposits are maintained in transactional accounts.</p> <p>(a) Less stable deposit: Less stable deposit is the portion of retail deposits that does not fall within the category of stable deposits.</p>
83, 86	Treatment of the possibility of early withdrawal of funding with maturity above 30 days (para 83 – retail)	<p>Retail deposits: Article 22 of the LCR Pillar 1 Notice stipulates that retail term deposits with a residual maturity or withdrawal notice period greater than 30 days will receive a 0% run-off rate if the depositor</p>

	deposits; para 86 – wholesale funding)	<p>has no legal right to withdraw deposits within the 30-day horizon of the LCR, or if early withdrawal results in a significant penalty that is materially greater than the loss of interest.</p> <p>As for retail term deposits raised by Japanese banks, they are commonly treated as demand deposits since banks allow a depositor to withdraw term deposits without imposing a significant penalty.</p> <p>(b) Unsecured wholesale funding: Article1-Q16 of the Q&amp;A stipulates that banks must include the funding with options that are exercisable at the investor’s discretion within the 30-calendar-day horizon in the calculation of its expected cash outflow.</p> <p>For funding with options exercisable at the bank’s discretion, banks are allowed to calculate maturity based on their pricing model. However, banks need to take into account reputational factors that may limit their ability not to exercise the option.</p>
90–91	Definition of exposure to small business customers is based on nominal euro amount (EUR 1 million)	<p>Article 1-(xlili) of the LCR Pillar 1 Notice defines the term “small business customer” as below.</p> <p>(a) The total amount of deposits received from one small business customer is less than JPY 100 million.</p> <p>(b) Either of the following conditions should be satisfied</p> <ul style="list-style-type: none"> <li>• If a bank has any exposure to a small business customer, loans extended to the customers are classified as “small business exposures” under the Standardised Approach, or “other retail exposures” under the IRB Approach.</li> <li>• If a bank does not have any exposure to a small business customer, the deposits received from the customers are managed as retail deposits.</li> </ul> <p>A limit of JPY 100 million is stricter than EUR 1 million based on the current exchange rate (EUR/JPY=127.83 as of end-March 2016). This implies that the scope of small business customers in Japanese regulation is narrower than in the Basel Standard.</p>
94–103	Deposits subject to “operational” relationships”	<p>Article 29 of the LCR Pillar 1 Notice specifies the provisions to the usage of a preferential 25% run-off rate. Banks need to notify the FSA in advance and verify whether their operational deposits satisfy all of the following requirements.</p> <p>1) Qualifying Activities</p> <ul style="list-style-type: none"> <li>• The deposits generated by clearing, custody or cash management activities.</li> <li>• The customer is reliant on the bank to perform these services as an independent third-party intermediary in order to fulfil its normal banking activities over the next 30 days.</li> <li>• The termination of such agreements shall be subject either to a notice period of at least 30 days or significant switching costs.</li> </ul> <p>2) Qualifying operational deposits</p> <ul style="list-style-type: none"> <li>• The deposits are by-products of the underlying services and not sought out in the wholesale market in the sole interest of offering interest income.</li> <li>• The deposits are held in specifically designated accounts and priced without giving an economic incentive to the customer (not limited to paying market interest rates) to leave any excess funds on these accounts.</li> </ul> <p>3) Quantitative criteria</p>



		<ul style="list-style-type: none"> <li>The amount of excess balances should be estimated based on sufficiently granular deposit data to adequately assess the risk of withdrawal in an idiosyncratic stress event.</li> <li>The methodology should take into account the relevant factors including concentration risk.</li> </ul> <p>4) Qualitative criteria</p> <ul style="list-style-type: none"> <li>The appropriateness of the amount of qualifying operational deposits should be verified periodically.</li> <li>The documentation of the internal policy, management and procedures should be prepared adequately.</li> <li>The methodology should be reviewed by internal audit at least once a year.</li> </ul>
131(f)	Definition of other financial institutions and other legal entities	"Other financial institutions" are defined as those institutions that are not subject to Basel capital adequacy standards or similar standards.

### Elements left to national discretion (non-comprehensive list)

Table A.7

Basel paragraph	Description	Implementation by the FSA
5	These two standards [the LCR and NSFR] comprise mainly specific parameters, which are internationally "harmonised" with prescribed values. <i>Certain parameters, however, contain elements of national discretion to reflect jurisdiction-specific conditions. In these cases, the parameters should be transparent and clearly outlined in the regulations of each jurisdiction to provide clarity both within the jurisdiction and internationally.</i>	Items on national discretion and their corresponding outflow or inflow rates are transparent and detailed in the LCR Pillar 1 Notice. The LCR Pillar 1 Notice is publicly available on the website of the FSA.
8	Use of phase-in options	The FSA follows the phase-in transitional arrangement proposed by Basel Committee to implement the LCR in Japan starting from 31 March 2015, with a 60% minimum requirement set for the year 2015, followed by increments of 10 percentage points per annum until reaching 100% by 1 January 2019.
11	The Committee also reaffirms its view that, during periods of stress, it would be entirely appropriate for banks to use their stock of HQLA, thereby falling below the minimum. Supervisors will subsequently assess this situation and will give guidance on usability according to circumstances. Furthermore, individual countries that are receiving financial support for macroeconomic and structural reform purposes may choose a different implementation schedule for their national banking systems, consistent with the design of their broader economic restructuring programme.	<p>The FSA's Supervisory Guidelines prescribes that banks shall submit the corrective action plans to improve the LCR according to Article 24 of the Banking Act in cases where the LCR falls (or is expected to fall) below the minimum requirements, and the FSA can issue a business improvement order according to Article 26 of the Banking Act if deemed necessary.</p> <p>However, these supervisor's actions shall be made flexibly case by case. During a period of financial stress, banks may be allowed by the FSA to use their stock of HQLA, thereby falling below the minimum required LCR.</p> <p>Japan is not receiving financial support for macroeconomic and structural reforms.</p>

50(b)	Eligibility of central bank reserves	Central bank reserves held at the Bank of Japan (including both required reserve and excess amount) are eligible as Level 1 assets.
50(c)	Marketable securities that are assigned a 0% risk weight under the Basel II Standardised Approach for credit risk	The FSA has introduced the national discretion of a 0% risk weight in the Basel II Standardised Approach. Regardless of its risk weight, Japanese government bonds denominated in JPY can be included in Level 1 assets based on the provision of Basel paragraph 50(c) or (d).
53–54	Eligible Level 2B assets	The FSA decided to include the category of Level 2B assets as stated in the Basel standard, with the exception of the restricted contractual committed liquidity facilities (RCLF). The main components of Level 2B assets for Japanese banks are equities that are constituents of the Tokyo Stock Price Index. Residential mortgage-backed securities issued in Japan are usually ineligible for Level 2B assets as the underlying mortgages are “non-recourse” rather than “full recourse”.
54a	Provision relating to the use of RCLF	NA
55(f)	Treatment for jurisdictions with insufficient HQLA (subject to separate peer review process)	NA
68	Treatment of Shariah-compliant banks	NA
78	Treatment of deposit insurance	The FSA assessed that the Japanese deposit insurance scheme and the savings insurance scheme satisfy the three criteria set out in paragraph 78 of the Basel standard. Thus, insured deposits are subject to a 3% run-off rate.
79(f)	Categories and run-off rates for less stable deposits	The FSA has currently set a 10% run-off rate for less stable deposits. Nevertheless, foreign currency deposits and those deposits that are important in terms of the internal liquidity risk management receive an outflow rate higher than 10% based on historical run-off rates in times of stress.
123	Market valuation changes on derivative transactions.	In addition to the 24-month Historical Lookback Approach proposed by the Basel LCR standard, the FSA has implemented an alternative approach (the scenario approach). This is a simulation-based approach and is similar to the IMM for counterparty credit risk exposure.  Banks can choose either option. However, prior review by the FSA is needed before a bank can use the scenario approach.
134–140	Run-off rates for other contingent funding liabilities.	The FSA sets the following run-off rates for contingent funding liabilities: <ul style="list-style-type: none"> <li>• Unconditionally revocable facilities: less than 3%</li> <li>• Guarantees, letters of credit: 2%</li> <li>• Customer short positions covered by other customers’ collateral: 50%</li> </ul>
160	Weight assigned to other contractual inflows.	The FSA has assigned a 100% weight to other contractual inflows. These inflows may include, but are not limited to, scheduled funding (eg issuance of corporate debts or capital increase), business transfers and sales of fixed assets (Article 73-Q1).
164–165	Determination of scope of application of LCR (whether to apply	The LCR requirements are applicable to internationally active banks in Japan on both a consolidated and non-consolidated basis.

	beyond “internationally active banks” etc) and scope of consolidation of entities within a banking group	For domestic banks, the FSA collects information on LCR and other monitoring metrics for supervision purpose and continues dialogue with banks instead of imposing regulation.
168–170	Differences in home/host liquidity requirements due to national discretions.	<p>When calculating the LCR on a consolidated basis, a cross-border banking group should apply the liquidity parameters adopted in the home jurisdiction to all legal entities being consolidated except for the treatment of retail/small business deposits that should follow the relevant parameters adopted in host jurisdictions in which the entities (branch or subsidiary) operate.</p> <p>Home requirements for retail and small business deposits should apply to all the legal entities (including branches of the bank) operating in host jurisdictions if: (i) the host jurisdiction has no requirements for retail and small business deposits; (ii) the host jurisdiction has not implemented the LCR; or (iii) the home requirements are stricter than the host requirements.</p>
Annex 2	Principles for assessing eligibility for ALA	NA