Basel Committee
on Banking Supervision

Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel large exposures regulations – Japan

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Contents

Glossary

BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
C	Compliant (grade)
CEM	Current exposure method
CIUs	Collective investment undertakings
D-SIB	Domestic systemically important bank
ECB	European Central Bank
FAQ	Frequently asked question
G-SIB	Global systemically important bank
JFSA	Japanese Financial Services Agency
JPY	Japanese yen
LC	Largely compliant (grade)
LEX	Large exposures
MNC	Materially non-compliant (grade)
NC	Non-compliant (grade)
RCAP	Regulatory Consistency Assessment Programme
SA-CCR	Standardised approach for counterparty credit risk

Preface

The Basel Committee on Banking Supervision (Basel Committee) places 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 fully, consistently and in a timely manner 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.[1]

This report presents the findings of an RCAP Assessment Team on the adoption of the Basel large exposures (LEX) framework in Japan. The assessment focused on the completeness and consistency of the Japanese regulations with the Basel LEX standard and relied on the translated regulations and information provided by the Japanese authorities.

The assessment began in September 2019 but was suspended in March 2020 due to Covid-19.[2] The assessment resumed in December 2021 with an Assessment Team led by Mr Daniel Perez, Director of the Regulation Department, Bank of Spain, and comprising four technical experts, from Hong Kong SAR, ECB Banking Supervision, Turkey and the United Kingdom (see Annex 1). The main counterparts for the assessment were the Japanese Financial Services Agency (JFSA) and the Bank of Japan. The work was coordinated by the Basel Committee Secretariat with support from Bank of Spain staff.

The assessment comprised (i) a self-assessment by the Japanese authorities; (ii) an assessment phase; and (iii) a review phase including a technical review of the Assessment Team's findings by a separate RCAP Review Team. The assessment report ultimately reflects the view of the Basel Committee.

The Assessment Team acknowledges the cooperation received from the JFSA and Bank of Japan throughout the assessment process.

[1] See www.bis.org/bcbs/implementation.htm.

[2] See www.bis.org/press/p200320.htm.

Executive summary

The Japanese rules implementing the large exposures framework into the Japanese Banking Act came into force on 1 April 2020. They are complemented by a number of regulations below the Banking Act and by JFSA Supervisory Guidelines and Q&A, which address more detailed points of interpretation.

As of 30 June 2022, the large exposures regulations in Japan are assessed as largely compliant with the Basel LEX framework. This is one notch below the highest overall grade. Two of the three components are assessed as largely compliant (Scope and definitions, and Value of exposures) and one component is assessed as compliant (Minimum requirements and transitional arrangements).

The Assessment Team identified six deviations and assessed two of them as potentially material. These two potentially material deviations relate to (i) the exclusion of two securities firms which are designated by Japanese authorities as domestic systemically important banks (D-SIBs) from the scope of the Japanese LEX implementation and (ii) the treatment of trading book derivatives. Both deviations are flagged as issues for follow-up RCAP assessments (Annex 4). The other four deviations are assessed as not material.

The Assessment Team also identified some observations relating to the three components of the Basel LEX framework.

Response from the Japanese authorities

The JFSA and the Bank of Japan thank the Assessment Team led by Mr Daniel Perez for their professional work throughout the assessment process. We appreciate, in particular, that the Assessment Team worked diligently during the pandemic and with the new format of full remote assessment. The constructive discussion throughout the evaluation process provided a valuable opportunity to reflect on the Japanese implementation of the LEX.

We believe the RCAP is a useful and important instrument to ensure consistency and transparency among cross-jurisdictional regulatory frameworks. We strongly support the implementation of a globally consistent LEX regulation and appreciate the Basel Committee's efforts to accomplish this goal.

Taking this opportunity, we would like to comment on two findings identified by the Assessment Team.

(i) Scope and level of application

While the two securities groups (final designated parent companies) are not subject to the current large exposure framework, the total assets of these groups stand for 5.7% and 2% of the total assets in the banking system and financial system, respectively. As correctly recognised by the Assessment Team, "Taking into account the relatively small share of these securities groups in the banking and financial system they are not expected to impact the international level playing field and financial stability at the moment." As the total assets of these groups have a stable trend, we do not consider that it is likely that the systemic importance of these securities groups would increase in the near future.

(ii) Calculation of exposure value for trading book positions

The sample banks focus mainly on commercial banking and they have small derivatives portfolio in their trading books. Thus, as noted in the report, the lack of clarity in measuring some trading book exposures does not reduce any large exposure by more than 0.5 percentage points for any sample bank. We do not think that the materiality of this deviation will increase in the near future.

The JFSA is currently proceeding with the revisions in Japanese LEX regulations to address the findings identified by the Assessment Team, and this is expected to be finalised by the end of 2022. We intend to request that the assessment grade be revised in a timely manner once this process is finalised.

1 Assessment context

1.1 Regulatory system

The JFSA 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 and supervision of private sector financial institutions and surveillance of securities transactions. In January 2001, the JFSA became an external organ of the Cabinet Office and took over responsibility for resolving failed financial institutions. The JFSA is now responsible for ensuring the stability of the financial system; protection of depositors, insurance policyholders and securities investors; and smooth intermediation, through such measures as planning and policymaking concerning the financial industry and market; and inspection and supervision of private sector financial institutions.[3]

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.

The JFSA's supervisory practice is governed by the Banking Act, which provides for JFSA independence in day-to-day bank supervision. Under the Banking Act, the JFSA may issue Notices. The JFSA also issues Q&A and Supervisory Guidelines. 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 and the LCR in Japan,[4] the Assessment Team finds that the LEX regulations in Japan meet the RCAP criteria of being enforceable and binding in practice.

1.2 Status of implementation of the large exposures framework

On 30 October 2019, the JFSA issued an Administrative Notice on the large exposures framework applicable to all commercial banks, including bank holding companies, and credit cooperatives pursuant to the Banking Act. The rules became effective on 1 April 2020. They are complemented by JFSA Supervisory Guidelines and Q&A, which address more detailed points of interpretation. For more detail on the legislation issued, see Annex 2.

1.3 Scope of the assessment

The Assessment Team considered the large exposures requirements applicable to commercial banks in Japan as of 30 June 2022. The assessment had two dimensions:

- a comparison of domestic regulations with the Basel large exposures framework to ascertain that all the required provisions have been adopted (*completeness* of the regulations); and

[3] 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 JFSA, although they have different powers to those used for bank regulation and supervision.

[4] Basel Committee on Banking Supervision (BCBS), Basel III regulatory consistency assessment (Level 2): Japan, www.bis.org/bcbs/implementation/l2_jp.pdf (October 2012), www.bis.org/bcbs/publ/d392.pdf (December 2016) and www.bis.org/bcbs/implementation/l2_jp.pdf (December 2016).

- whether there are any differences in substance between the domestic regulations and the Basel large exposures framework and, if so, their significance (*consistency* of the regulations).

In its assessment, the RCAP Assessment Team considered all binding documents that effectively implement the large exposures standard in Japan. Annex 2 lists the Basel standards used as the basis for the assessment. The assessment did not evaluate the resilience of the banking system in Japan or the supervisory effectiveness of the Japanese authorities.

The Assessment Team evaluated the materiality and potential materiality of identified deviations between the Basel LEX framework and the Japanese regulations. The evaluation was made using a sample of five internationally active banks in Japan. Together, these banks comprise 52.6% of the total assets of the banking system and 82.8% of the total assets of internationally active banks in Japan as of end-September 2021. As of end-December 2021, there are 112 banks in Japan, of which 19 are internationally active. Internationally active banks are defined as banks that have one or more branches or subsidiaries outside Japan. In addition, the Assessment Team reviewed the non-quantifiable aspects of identified deviations and applied expert judgment as to whether the domestic regulations meet the Basel framework in letter and in spirit. The materiality analysis is summarised in Annex 3, which also lists the sample of banks.

The outcome of the assessment is summarised using a four-grade scale, both at the level of each of the three key components of the Basel large exposures framework and the overall assessment of compliance. The four grades are: compliant (C), largely compliant (LC), materially non-compliant (MNC) and non-compliant (NC).

2 Assessment findings

2.1 Assessment grades and summary of findings

Overall, the Assessment Team finds the implementation of the large exposures framework in Japan to be largely compliant with the Basel standards. This grade is based on the materiality assessment (summarised in Annex 3)

Assessment grades — Table 1

Component of the Basel LEX framework	Grade
Overall grade	LC
Scope and definitions	LC
Minimum requirements and transitional arrangements	C
Value of exposures	LC

Assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

2.1.1 Scope and definitions

This component is assessed as largely compliant with the Basel LEX standard.

The Assessment Team identified two findings under Japanese regulations with respect to (i) the scope of application of the LEX standard and (ii) exemptions of some exposures from the large exposure limit.

The Basel LEX framework is applicable to all internationally active banks. However, some securities groups (final designated parent companies), which are designated as internationally active and as D-SIBs in Japan, are not subject to the LEX framework, while being subject to other Japanese regulatory standards including on capital and liquidity. This finding is assessed as potentially material.

The Japanese regulations exempt exposures resulting from a merger/business acquisition from the large exposure limit. Moreover, reasons such as mergers based on the Deposit Insurance Act, temporary capital amount reductions or others found to be appropriate by the Commissioner might apply as an exception for the application of the large exposure limit. Based on the very limited use of such exemptions, this finding is assessed as not material.

There is one observation relating to economic dependence that the Japanese authorities prescribed, as stated in the Basel LEX standard, in legally binding Supervisory Guidelines. The JFSA also requires internationally active banks to submit the data on exposures with economic dependence as determined in the Supervisory Guidelines on a regular basis.

2.1.2 Minimum requirements and transitional arrangements

This component is assessed as compliant with the Basel LEX standard. No findings were identified.

There are two observations relating to (i) the reporting of limit breaches and (ii) the implementation date of the LEX standard.

In the Japanese regulations there are overarching rules for banks to report any compliance issues to the JFSA even if there is no explicit statutory reporting requirement. Based on the meetings with banks and the Japanese authorities, it is understood that banks report to the JFSA when a limit breach under the large exposures regulation takes place or is expected to take place.

The other observation is that the implementation date in Japan is 1 April 2020, over one year after the Basel Committee's agreed implementation date of January 2019.

2.1.3 Value of exposures

This component is assessed as largely compliant with the Basel LEX standard. The Assessment Team identified four findings.

First, the calculation of exposure values of swaps, futures, forwards, credit derivatives and options in the trading book under the Japanese LEX regulations is not clearly specified. For the treatment of these instruments the Japanese regulations refer to the Japanese capital requirement treatment, which differs from the Basel LEX standard. The Japanese LEX framework takes into account only the counterparty credit risk of these instruments and does not specify a clear calculation method for the exposure to underlying assets. As a consequence, exposures held through derivatives in the trading book may not be taken into account according to the Basel LEX standard. The lack of specific provisions for the quantification of exposures resulting from derivatives is considered a structural deficiency that could be used by banks to increase their exposures to a certain counterparty above the prescribed large exposure limits. This finding is assessed as potentially material.

Second, the Japanese regulations do not explicitly disallow netting across banking book and trading book. Based on the data provided by the Japanese authorities and meetings held with banks and the authorities, this finding is assessed as not material.

Third, unlike the Basel LEX standard, the Japanese regulations allow general exemptions from the look-through approach, including for the unfunded portion of an investment fund for which a bank has to pay when it receives a capital call. However, there are no indications that such exemptions may result in a significant impact on large exposure figures of Japanese banks, and hence this deviation is assessed as not material.

Fourth, the Japanese regulations do not specify the quantification of individual components of exposures to non-qualifying central counterparties. Due to the limited exposure of Japanese banks to non-qualifying central counterparties, this finding is assessed as not material.

There are also some observations relating notably to (i) the calculation of the exposure value for instruments that give rise to counterparty credit risk and are not securities financing transactions and (ii) the application of the stricter 15% limit.

The Japanese authorities implemented the final rule for SA-CCR in March 2018 and it has been in force since then. During the transition, the JFSA permits the use of the current exposure method (CEM), which is the Committee's previous standard for measuring counterparty credit risk. All the sample banks in the LEX assessment use the CEM for banking book on-balance sheet non-derivative assets in the LEX calculations. The Japanese authorities stated that the JFSA has published the final rules of the finalised Basel III standards, and the rules are scheduled to be implemented by internationally active banks no later than the end of March 2024. Following the application of the final rules of the Basel III standards, Japanese internationally active banks will no longer be able to use the CEM after the end of March 2024.

The large exposure limit applied to a G-SIB's exposure to another G-SIB is set at 15% of the eligible capital base. The 15% limit is not applied to D-SIBs under the Japanese regulations.

2.2 Detailed assessment findings

2.2.1 Scope and definitions

Section grade	**Largely compliant**
Basel paragraph number	11: Scope and level of application
Reference in the domestic regulation	Article 13, paragraph (2) of the Banking Act
Finding	The Basel LEX framework is applicable to all internationally active banks. All commercial banks, including bank holding companies, and credit cooperatives are under the scope of the Japanese large exposures framework. However, some securities groups (final designated parent companies), which are designated not only as internationally active but also as D-SIBs, are not subject to the large exposures framework, while being subject to other Japanese regulatory standards for banks including on capital and liquidity. The Japanese authorities stated that the JFSA is drafting the proposed regulations and planning to launch a public consultation in line with the Basel LEX framework in the course of 2022. After taking into account the results of the public consultation, the authorities plan to implement the updated regulations by the end of 2022. Based on the data received from the authorities, the total assets of these securities groups stand for 5.7% and 2% of the total assets in the banking system and financial system, respectively. Taking into account the relatively small share of these securities groups in the banking and financial system, they are not expected to impact the international level playing field and financial stability at the moment. However, the Assessment Team considers that there is a reasonable chance that the systemic importance of these securities groups may increase in near future. Hence, the finding is assessed as potentially material.
Materiality	Potentially material
Basel paragraph number	13: Scope of counterparties and exemptions
Reference in the domestic regulation	Article 13, paragraph (2) of the Banking Act Article 14-4 of the Regulation for Enforcement of the Banking Act Article 4-2 of the Order for Enforcement of the Banking Act Article 9, paragraph (1) of the Public Notice of the Financial Services Agency No. 51 of 2014

Finding	The Basel LEX framework exempts exposures to sovereigns and their central banks. This exemption also applies to public sector entities treated as sovereigns according to the risk-based capital framework. The JFSA regulations state that, if the total amount of credit extended by a bank or bank holding company to a single person exceeds the large exposures limit as a result of a merger or business acquisition by the person to which the credit is extended, or due to a compelling reason as specified by the Cabinet Order, then the large exposure limit does not apply. The compelling reasons that might apply as an exception for the implementation of the large exposures limit are provided below. i) Merger based on the Deposit Insurance Act Under the Deposit Insurance Act, there is a special merger procedure in order to resolve a failed financial institution with official approval. When such a special merger is conducted, an exceptional treatment regarding LEX regulations is necessary. Then, to conduct a merger based on the Deposit Insurance Act is stated as "unavoidable reasons" in Article 14-3, paragraph 2, item (i) of the Regulation for Enforcement of the Banking Act. ii) Temporary reduction of capital iii) Others found to be appropriate by the Commissioner of the JFSA. Prior to the revisions to the Japanese LEX regulations in April 2020, the Japanese LEX framework included intra-group exposures and was therefore more conservative than the Basel LEX framework in this regard. To date, the Japanese authorities have approved only two exemptions for internationally active banks to address cases where intra-group exposures exceeded the large exposure limit. Based on the very limited exemptions granted by the Japanese authorities and used only for exposures that are not in scope of the Basel LEX framework, the deviation is assessed as not material.
Materiality	Not material

2.2.2 Minimum requirements and transitional arrangements

This component was assessed to be compliant with the Basel framework. No findings were identified.

2.2.3 Value of exposures

Section grade	**Largely compliant**
Basel paragraph number	47–49: Calculation of exposure value for trading book positions
Reference in the domestic regulation	Article 4, paragraph (6), item (iv) of the Order for Enforcement of the Banking Act Article 14, paragraph (4) of the Regulation for Enforcement of the Banking Act Article 3 item (ii) of the Public Notice of the Financial Services Agency No. 51 of 2014
Finding	The Basel LEX framework states that instruments such as swaps, futures, forwards and credit derivatives must be converted into positions following the risk-based capital requirements and these instruments need to be decomposed into their individual legs. Only transaction legs representing exposures in the scope of the large exposures framework need to be considered. Moreover, the Basel LEX framework requires that, for credit derivatives that represent sold protection, the exposure to the referenced name must be the amount due in the case that the respective referenced name triggers the instrument, minus the absolute value of the credit protection. The exposure values of options under the large exposures framework also differ from the exposure value used for risk-based capital requirements. They must be based on the change(s) in option prices that would result from a default of the respective underlying instrument. The treatment of instruments such as swaps, futures, forwards, credit derivatives and options under the Japanese LEX regulation is not clearly specified. For the treatment of these instruments the JFSA regulations refer to the capital requirement treatment, which differs from the Basel LEX standard. The Japanese LEX framework stipulates only that banks must recognise derivatives and refers to the regulation on capital requirements

	for the treatment without specifying a clear calculation method for the exposure to underlying assets. As a consequence, exposures held through derivatives in the trading book may not to be taken into account in an appropriate way. The lack of specific provisions for the quantification of exposures resulting from derivatives is considered a structural deficiency that could be used by banks to increase their exposures to a certain counterparty above the prescribed limits. The Japanese authorities stated that, to ensure the consistency among banks' practices, the relevant provisions will be reviewed in near future. Based on the data received from the authorities, the current Japanese treatment mentioned above does not reduce any large exposure, as a percentage of eligible capital, by more than 0.5 percentage points for any sample bank mainly due to the sample banks' relatively small derivatives portfolio in their trading books. While the current impact of the deviation is not material, the likelihood of an increase in Japanese banks' derivative portfolios is plausible, which would result in an increasing materiality of this deviation in the near future. Hence, this finding is assessed as potentially material.
Materiality	Potentially material
Basel paragraph number	58: Offsetting short positions in the trading book against long positions in the banking book
Reference in the domestic regulation	Article 4, paragraph (6) of the Order for Enforcement of the Banking Act Article 14, paragraph (1) to (4) of the Regulation for Enforcement of the Banking Act Guideline for Large Exposures Regulation
Finding	The Basel LEX does not permit netting across the banking book and trading book. The JFSA regulations do not explicitly disallow the netting across banking book and trading book. Based on the data provided by the Japanese authorities, two out of the five sample banks have no trading book exposures to any of their top 20 counterparties. For the remaining three banks, trading book exposures to their top 20 counterparties individually do not make up more than 3% of Tier 1 capital. Meetings held with banks and the Japanese authorities also indicated that the probability of netting across the banking book and the trading book is very low. Hence, this finding is assessed as not material.
Materiality	Not material
Basel paragraph number	72: CIUs, securitisation vehicles and other structures
Reference in the domestic regulation	Article 14, paragraph (6) of the Regulation for Enforcement of the Banking Act Article 4-3 of the Public Notice of the Financial Services Agency No. 51 of 2014
Finding	The Basel LEX framework requires a look-through approach for positions held through a structure such as collective investment undertakings (CIUs), securitisation vehicles and other structures. It states possible exemptions from that principle and subjects them to quantitative limits. The Japanese framework allows general exemptions from the look-through approach, including for the unfunded portion of an investment fund for which a bank has to pay when it receives a capital call. However, there are no indications that such exemptions may result in a significant impact on large exposure figures of Japanese banks. Hence, this finding is assessed as not material.
Materiality	Not material
Basel paragraph number	87: Exposures to central counterparties
Reference in the domestic regulation	Article 14, paragraph (4), item (6) and (10) of the Regulation for Enforcement of the Banking Act Article 4-2, Public Notice of the Financial Services Agency No. 51 of 2014 refers to the Public Notice on Capital Adequacy Ratio.

Finding	The Basel LEX framework requires the identification of exposures to non-qualifying central counterparties and specifies the quantification of individual components. Trade exposures: the exposure values may differ for derivatives as the Japanese regulation does not specify how they have to be quantified. Segregated initial margins: footnote 23 LEX is not explicitly included in the Japanese regulation. Pre-funded and unfunded default fund contributions: it is not clear how these are treated under the Japanese regulation. Due to the limited exposure of Japanese banks to non-qualifying central counterparties, this finding is assessed as not material.
Materiality	Not material

2.3 Observations on the implementation of the large exposures framework in Japan

The following observations highlight certain special features of the regulatory implementation of the Basel large exposures framework in Japan. These are presented to provide additional context and information. Observations are considered compliant with the Basel standards and do not have a bearing on the assessment outcome.

2.3.1 Scope and definitions

Basel paragraph number	19–20: Definition of connected counterparties
Reference in the domestic regulation	Article 13, paragraph (1) of the Banking Act Article 4, paragraph (1) to (3) of the Order for Enforcement of the Banking Act Article 13-9 to Article 13-11 of the Regulation for Enforcement of the Banking Act III-2-3-2-2-2(1) of Supervisory Guidelines
Observation	The Basel LEX framework requires banks to take into account all individual entities included within a group of connected counterparties when calculating the large exposure limit. The large exposure limits of the Basel LEX standard are set out in the Order for Enforcement of the Banking Act. The Order details a concept of connected clients that is based mainly on the control relationship. The Japanese authorities prescribed economic dependence, as stated in the Basel LEX standard, in legally binding Supervisory Guidelines. The JFSA also requires internationally active banks to submit the data on exposures with economic dependence as determined in the Supervisory Guidelines on a regular basis.

2.3.2 Minimum requirements and transitional arrangements

Basel paragraph number	18: Minimum requirement – the large exposure limit
Reference in the domestic regulation	Article 13, paragraph (2) and paragraph (1) of the Banking Act
Observation	The Basel LEX framework requires that breaches of the large exposures limit must be communicated immediately to the regulator and rapidly rectified. In Japanese regulations there are overarching rules for banks to report any compliance issues to the JFSA, even if there is no explicit statutory reporting requirement. Based on the meetings with banks and the Japanese authorities, it is understood that banks report to the JFSA when a limit breach under the large exposures regulation takes place or is expected to take place.
Basel paragraph number	93: Implementation date and transitional arrangements

Reference in the domestic regulation	Article 1 of Supplementary Provisions of the Order for Enforcement of the Banking Act [Act No.139 of October 30, 2019]
Observation	The Japanese regulation entered into force on 1 April 2020.

2.3.3 Value of exposures

Basel paragraph number	33: Banking book on-balance sheet non-derivative assets
Reference in the domestic regulation	Article 4, paragraph (6), item (iv) of the Order for Enforcement of the Banking Act Article 14, paragraph (4) of the Regulation for Enforcement of the Banking Act Article 3 and Article 4 of the Public Notice of the Financial Services Agency No. 51 of 2014 Article 79, paragraph (1) of the Public Notice on Capital Adequacy Ratio
Observation	The Basel LEX framework requests that the Basel standardised approach to counterparty credit risk (SA-CCR) be used to calculate the exposure value for instruments that give rise to counterparty credit risk and are not securities financing transactions. The Japanese authorities implemented the final rule for SA-CCR in March 2018 and it has been in force since then. Nevertheless, the JFSA still permits the use of the CEM, which is the Committee's previous standard for measuring counterparty credit risk, to calculate the value for the instruments mentioned above. All the sample banks in the LEX assessment use the CEM for banking book on-balance sheet non-derivative assets in the LEX calculations. The Japanese authorities stated that the JFSA has published the final rules of the finalised Basel III standards, and the rules are scheduled to be implemented for internationally active banks by no later than the end of March 2024. Following the application of the final rules of the Basel III standards, Japanese internationally active banks will no longer be able to use the CEM after the end of March 2024.
Basel paragraph number	51: Offsetting between long and short positions in the same issue
Reference in the domestic regulation	Article 14, paragraph (4), item (vi) of the Regulation for Enforcement of the Banking Act Guideline for Large Exposures Regulation "Re: Article 14, paragraph (4), item (vi) of the Regulation for Enforcement of the Banking Act"
Observation	The Basel LEX framework states that banks may offset long and short positions in the same issue. In the Basel framework, two issues are defined as the same if the issuer, coupon, currency and maturity are identical. Even though there is no explicit definition of the same issue in the JFSA regulations as in the Basel LEX standard, positions in different issues from the same counterparty are treated as different issues in domestic LEX regulations. Moreover, based on the meetings with banks and the Japanese authorities it is understood that banks offset long and short positions in the same issue only if the issuer, coupon, currency, and maturity are the same.
Basel paragraph number	65–66: Interbank exposures
Reference in the domestic regulation	Article 13, paragraph (2) of the Banking Act III-2-3-2-6(5)(ii)(c) of Supervisory Guidelines
Observation	The Basel LEX framework includes explicit exemption for all intraday interbank exposures. It also states that, in stressed circumstances, supervisors may have to accept a breach of an interbank limit ex post. The Japanese framework allows banks to seek pre-approvals for a range of limit breaches. However, such pre-approvals seem to be a rare occurrence.
Basel paragraph number	68–71: Covered bonds
Reference in the domestic regulation	n/a
Observation	There is no preferential treatment for qualifying covered bonds under the Japanese regulation.
Basel paragraph number	90: Large exposure rules for G-SIBs

Reference in the domestic regulation	Article 16-2-3, paragraph (3), item (2) and paragraph (4), item (3) of the Order for Enforcement of the Banking Act Article 10 of the Public Notice of the Financial Services Agency No. 51 of 2014
Observation	The stricter 15% limit is not applied to D-SIBs under the Japanese regulation.

Annexes

Annex 1: RCAP Assessment Team and Review Team

Assessment Team Leader

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Mr Giuseppe Siani	ECB Banking Supervision (until March 2020)

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Mr Puneet Pancholy	Basel Committee Secretariat (until 31 October 2021)
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Review Team members

Mr Yasser S Alghofily	Saudi Central Bank
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Mr Stefan Hohl	Basel Committee Secretariat
Mr Tony	Indonesian Financial Services Authority

Annex 2: List of Basel standards and implementing regulations issued by the Japanese authorities

The following Basel standards were used as the basis of this RCAP assessment:

- *Supervisory framework for measuring and controlling large exposures*, April 2014
- *Frequently asked questions on the supervisory framework for measuring and controlling large exposures*, September 2016

Table A.1 lists the regulations issued by the Japanese authorities to implement the large exposures framework in Japan. Previous RCAP assessments of Japan's implementation of the Basel standards considered the binding nature of its regulatory documents.[5] This RCAP Assessment Team did not repeat that assessment, but instead relied on the previous assessments' findings. Those assessments concluded that the types of instrument described in Table A.1 could be considered as binding on banks and supervisors for the purposes of an RCAP assessment.

Overview of relevant Japanese large exposure regulations — Table A.1

Domestic regulations	Type, version and date
Banking Act (Act No. 59 of June 1, 1981)	Law issued in June 1981 and revised subsequently (most recently in June 2021)
Order for Enforcement of the Banking Act (Cabinet Order No. 40 of March 27, 1982)	Law issued in March 1982 and revised subsequently (most recently in November 2021)
Regulation for Enforcement of the Banking Act (Ministry of Finance Order No. 10 of March 31, 1982)	Law issued in March 1982 and revised subsequently (most recently in April 2022)
Public Notice on Adjustment Necessary in Relation to Amount of Equity Capital Calculated According to Standards Specified in Article 14-2, Item (i) of the Banking Act Pursuant to Article 14-2, Paragraph (3) of the Regulation for Enforcement of the Banking Act (Public Notice of the Financial Supervisory Agency and Ministry of Finance No. 31 of 1998)	Public Notice issued in November 1998, revised in October 2019
Public Notice on Adjustment Necessary in Relation to Amount of Equity Capital Calculated According to Standards Specified in Article 14-2, Item (ii) and Article 52-25 of the Banking Act Pursuant to Article 14-5, Paragraph (4) and Article 34-15, Paragraph (5) of the Regulation for Enforcement of the Banking Act (Public Notice of the Financial Supervisory Agency and Ministry of Finance No. 33 of 1998)	Public Notice issued in November 1998, revised in October 2019

[5] Please see Annex 5, Assessment of the bindingness of regulatory documents, www.bis.org/bcbs/publ/d391.pdf.

Public Notice on Persons, etc. Specified by the Commissioner of the Financial Services Agency as Those Excluded from Definition of Combined Affiliated Corporations, etc. Pursuant to Article 4, Paragraph (13), Item (iv) and Article 16-2-3, Paragraph (3), Item (ii) of the Order for Enforcement of the Banking Act as Well as Article 13-11, Paragraph (2), Article 14, Paragraphs (2) and (4) to (6), Article 14-2, Paragraphs (1) and (2) and Article 14-4 of the Regulation for Enforcement of the Banking Act (Public Notice of the Financial Services Agency No. 51 of 2014)	Public Notice issued in October 2014, revised in October 2019
Guideline for Large Exposures Regulation	Regulation issued in October 2019
Supervisory Guidelines	Regulation issued in October 2005 and revised subsequently (most recently in June 2022)

Source: JFSA.

Annex 3: Materiality assessment

The outcome of the RCAP assessment is based on the materiality of the findings described in Section 2.2 and summarised in Table A.2. Assessment Teams evaluate the materiality of findings quantitatively where possible, or using expert judgment when the impact cannot be quantified.

The materiality assessment for quantifiable gaps is based on the cumulative impact of the identified deviations on the reported large exposures of banks in the RCAP sample. These banks are listed in Table A.3.

Number of deviations by component

Table A.2

Component	Not material	Potentially material	Material
Scope and definitions	1	1	0
Minimum requirements and transitional arrangements	0	0	0
Value of exposures	3	1	0

RCAP sample banks

Table A.3

Banking group	Share of banks' assets in the total assets of the Japanese banking system (September 2021)
Mitsubishi UFJ Financial Group	19.0%
Sumitomo Mitsui Financial Group	12.9%
Mizuho Financial Group	12.0%
Sumitomo Mitsui Trust Holdings	3.3%
Norinchukin Bank	5.5%
Total	52.6%

Source: JFSA. For this purpose, banking assets are based on the measure of total exposures used in the leverage ratio, which includes both on- and off-balance sheet exposures.

Annex 4: Issues for follow-up RCAP assessments

The assessment team has identified the issues below for follow-up RCAP assessments to align the Japanese LEX regulations with the Basel LEX Standard.

1. Exclusion of some internationally active D-SIBs from the scope of LEX implementation.
2. Calculation of exposure values of swaps, futures, forwards, credit derivatives and options in the trading book.