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TCH-IIF Colloquium on Cross-Border Resolution
Keynote Address As Prepared for Delivery
– What we have achieved so far, and what remains to be done?–
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It is my great honor and pleasure to be here with you today. Like yourselves, I found today’s discussions extremely timely and relevant in the process of ending the so-called Too-Big-To-Fail issue as agreed by the G20 and the Financial Stability Board (FSB). Cross-border resolution is a key element of this TBTF work as you are well aware.

As an official who has been closely involved in the resolution of banks, securities firms and insurance companies in my country and abroad, I would like to offer some of my thoughts on the achievements in and challenges for cross-border resolution of global systemically important financial institutions.

Since the global financial crisis erupted in 2008, the global regulatory community has placed priority on enabling an orderly resolution of global systemically important financial institutions (G-SIFIs) without the taxpayers incurring losses, and reduce the moral hazard associated with the prospect of such rescue operations, sometimes called the “Heads I win, tails you lose” problem.

As you are aware, and much to your credit, we have made a significant step forward at the Financial Stability Board (FSB) this fall, by developing a proposal on total loss absorbing capacity (TLAC) and starting a process for enabling the imposition of cross-border stays and bail-in operations by way of adopting a revised ISDA Protocol in the near term. The authorities of home jurisdictions of the major cross-border SIFIs have committed themselves to implement those arrangements in accordance with the agreed timeline and following an
agreed procedure.

A lot of progress has certainly been made in thinking through the cross-border implementation of resolution plans either taking the form of single-point-of-entry (SPE) or multiple-points-of-entry (MPE) strategies. Cooperation agreements have been negotiated between authorities, and resolvability assessments have been undertaken. Crisis management groups (CMGs) have become operational.

However, while the achievements are by all means significant, this is only the beginning of a process and much work still remains. The final rules for TLAC will have to be agreed after a thorough quantitative impact assessment and market survey, accompanied by a macro and micro-economic analysis of the likely impact of the agreed rules. The final calibration of the minimum requirements and internal TLAC arrangements as well as limitations on qualified investors will have to be made on a fully-informed basis and in a manner consistent with the likely impact on banks’ behavior and the role of those banks in providing finance for growth.

A particular challenge may be to have the arrangements work in multiple jurisdictions that are either home or host to the major G-SIFIS in one way or another. Cross-border issues are particularly challenging, as developing and implementing a set of arrangements covering all significant host jurisdictions is proving to be a major endeavor, which will take years to accomplish. What happens in reality during the transition period, and in the relatively less significant jurisdictions will have to remain uncertain for many years.

So this is why I call this recent step merely the start of a process even after the G20 Leaders declared the substantial completion of the global regulatory reform process after the financial crisis. We must admit that there needs to be a backstop to counter any unforeseen events destabilizing the global financial system in the interim, and perhaps even in the longer run, as no resolution regime can be expected to work perfectly during a severe financial crisis which may still occur from
time to time.

In this sense, I would like to call for a sense of realism, and humility. While it is important to complete the remaining elements of the resolution work, including the establishment of cross-border arrangements and infrastructures necessary, it is not enough. The combination of TLAC and ISDA Protocol can never be a panacea. In my view, we must address the fundamental issue of re-building trust, both between the public and the financial institutions, and between regulators of different jurisdictions. Unfortunately, at the moment, there is still a lingering deficit of trust and cooperation on both fronts. How far we have come to address those issues is a very open question, at least in my view.

Needless to say, finance is built on trust. And the global financial crisis has dealt a devastating blow to the cross-border trust we had before the crisis. The public’s trust in financial institutions may have entered another low point, as market conduct issues have surfaced in many areas across the major jurisdictions, including attempts to manipulate mortgage rates and forex fixes. Trust between financial institutions has suffered a significant blow with many cases around interbank market manipulations taken to justice. Even trust in the ability of sovereigns to stabilize the financial system through governmental support has diminished.

While memories of the severest spats of the financial crisis might fade with the passing of time, the fundamental issues remain. We somehow have to deal squarely with this challenge of re-building trust in the financial system.

This is probably why regulators around the world are increasingly interested in addressing risk culture and market conduct in recent years, and are determined to come to the bottom of those issues. Regulators do understand that regulatory certainty and transparency has not been perfect during this time, but the importance of dealing with those fundamental issues is not something we can ignore or
underestimate. The process can be handled better if we had better international and inter-agency coordination in some jurisdictions, but it cannot be avoided.

In Japan, we have seen this before. Trust did not return until after we underwent a significant strengthening of the resolution regimes for financial institutions, and with a lot of public support in capital injection, nationalization and orderly resolution of a larger number of financial institutions with full protection of depositors. While Japan has developed a resilient and robust resolution regime for financial institutions based on ex ante and ex post contributions from the industry, it has not denied itself the possibility of using taxpayers’ money and confidence in the government budget to provide resources as a last resort.

Having emphasized the importance of culture, however, I cannot simply leave it to philosophers or religious figures to address this problem. The Archbishop of Canterbury stressed the importance of meditation and self-reflection for financiers in his remarks in a recent public conference at the IMF, but it must be the responsibility of regulators to provide the right incentives in the development of the relevant rules and guidance, and to conduct regular assessments of risk culture through inspections and interviews with management.

One lesson we probably learned in the painful way through our own crisis in Japan between approximately 1992 and 2003 was that blind trust cannot succeed, and transparency and accountability are powerful tools for re-building trust. Capital is important, but it is only one element. Some will say liquidity is even more important, but it is still a means of simply honoring commitments and continuing critical functions. Credibility of an orderly resolution process is not just a function of the amount of capital available, but also in the capacity and competence of the resolution authorities to orchestrate an orderly process.

It is here that I would like to appeal for your understanding and your
further cooperation. Litigation risk can never be eliminated, and you can be as cynical as much as you wish to be, but if the public can be made to have a certain level of confidence in the ability of resolution authorities to organize an orderly resolution, there will be a fundamental difference.

In closing, I can report, based on my own experience and my country’s painful past, the four lessons in coping with a financial crisis and restoring confidence. While each crisis will be different, and financial systems sometimes differ significantly across jurisdictions, they have some universal relevance in my view.

One is to come to terms with non-performing loans or assets of the financial system, and to disclose the reality comprehensively and in a timely manner.

Second is to dispose of or remove those bad assets from the balance sheets of financial institutions as quickly as possible.

Third is to recapitalize those financial institutions promptly and in a credible manner. Use of public funds should not be ruled out, but if such possibility is denied, they should have sufficient loss-absorption and recapitalization capacity at the level of each institution, complemented with a resilient and robust, industry-funded resolution fund that can be mobilized for such purpose. If such fund is credibly pre-funded, it can complement and at least partly substitute for individual defenses. Temporary nationalization may be justified if restoring confidence is not possible through other means.

Fourth, it is of critical importance to prevent moral hazard and hold those responsible for mismanagement or defective governance to account in a credible manner, to establish accountability and make for credible deterrence of future misbehavior. Removal of old management and pursuit of individual liability may be important elements in this process. Transparency and disclosure will play important roles in this process. The Financial Services Agency of Japan was born in the midst
of Japan’s financial crisis and maintains transparency and fairness at the very heart of its mission.
I believe the multiple strands of work we are undertaking at the FSB and elsewhere at the moment around the issue of resolution can all be tied to each of those steps in coping with financial crises, but in the cross-border context. The much more integrated and inter-connected global financial system certainly requires an internationally coordinated approach to the issues, which inevitably makes it more complex and challenging. But we must do it.

When we talk about cross-border resolution, we can easily be bogged down in the details of legal interpretation or difficulty of cross-border recognition of legal frameworks and operations. However, if we take a broader view, and look across the efforts made by jurisdictions in coping with financial crises, and to prevent the recurrence of them, you will find there are actually so many common objectives and similarities of approaches, and that overall, mutual trust and enhanced cooperation are always keys to progress and ultimate success.

Regulators must be aware that designing better regulation and implementing them in normal times is easier compared to actually dealing with and managing a financial crisis of the future. Trust needs to be established before the next crisis happens, and enhanced cooperation is a must, not an option, if we wish to have the global financial system more or less keep on performing the role it plays today.

The financial system is there to serve the real economy, not the other way around. Resolution is important but just one element in our continuing endeavor to develop and maintain a global financial system that provides the services essential for the global economy in a sustainable manner. We certainly need your help and understanding in making this happen.

Thank you very much.