IADI Asia-Pacific Regional Committee (APRC) International Conference Opening Remarks

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(Introduction)

- Good morning, everyone. I am Junichi Nakajima, Commissioner of the Financial Services Agency (FSA).
  It is my great pleasure to have this opportunity to deliver the opening remarks. I would also like to express my sincere gratitude to the Deposit Insurance Corporation of Japan (DICJ), the Governor Mitsui, and IADI for hosting this event.
  Today, let me briefly talk about i) recent cases of banking failure and lessons learnt and ii) the Japanese authority's supervisory approach and safety net.

(Recent cases)

- As you know, Silicon Valley Bank and Signature Bank failed on March 10 and 12, respectively. Against these banks, the resolution was carried out under the receivership of the FDIC while protecting all deposits. Triggered by the failure of U.S. banks, the credit concern about Credit Suisse re-surged. On March 19, Credit Suisse was acquired by UBS while receiving support from the Swiss authorities. Moreover, on May first, First Republic Bank failed, and JPMorgan Chase took over all of its deposits and almost all of its assets
- Against this backdrop, the statement of the G7 Minister of Finance and Central Bank Governors held in Niigata this month reaffirmed that the financial system is resilient, supported by the financial regulatory reforms implemented after the 2008 global financial crisis. And it was agreed to continue to monitor financial sector developments and stand ready to take appropriate actions to maintain financial stability and the resilience of the global financial system.
  In addition, the communique states that we will address data, supervisory, and regulatory gaps in the banking system

- As an example of these supervisory and regulatory gaps, the recent report released by the US authorities points out the key takeaways of Silicon Valley Bank’s failure, including: Silicon Valley Bank's board of directors and management failed to manage their risks; and supervisors did not fully appreciate the extent of the vulnerabilities as Silicon Valley Bank grew in size and complexity.

(Lessons)

- So, what lessons should the authorities and banks learn from these recent events? Let me talk about four key lessons:
  - First is to address rapid deposit outflows in the digital age. In the case of Silicon Valley Bank, the liquidity stress and bank run occurred due to a loss of confidence in the bank, which are accelerated by social media and exacerbated by the high proportion of uninsured deposits. Once a deposit run has started, it is not easy to contain or control. Banks, therefore, need to monitor various qualitative and quantitative indicators and take appropriate measures before a devastating run starts. As part of the monitoring exercises by supervisory authorities, it is key to review the adequacy of the operational aspects of liquidity risk management, i.e., whether banks’ contingency plans are up to date and whether they are well prepared to carry out the plans when necessary.
  - The second lesson is the risk of securities investment in times of rising interest rates. In the case of Silicon Valley Bank, as the Federal Reserve raised interest rates, on the asset side, the levels of unrealized loss on available-for-sale and held-to-maturity securities have risen significantly due to rapid increases in interest rates. At the same time, on the liability side, higher interest rates have brought an end to the influx of cheap funds to venture firms, and the total amount of deposits started to decline. Banks, therefore, needed to sell bonds to accommodate liquidity needs, and the unrealized losses had to be realized. The importance is stressed on effective and dynamic ALM integrating interest rate risk and liquidity risk, taking into account the concentration of deposits in terms of the business model.
  - These bring me to my third point, the importance of monitoring reflecting a business model. The Credit Suisse case suggests that even with high level of capital ratio, a loss of confidence in a business model can lead to a crisis. The

viability of a business model needs to be a key perspective of supervision and monitoring.

  - Finally, let me note the importance of effective banking supervision. It is banks' responsibility to develop effective risk management and sustainable business models. Yet, it is supervisors' responsibility to protect public and financial systems from the consequences of poor bank management. It remains important to continuously strive to address key supervisory issues through effective monitoring and in-depth dialogue with financial institutions.

- From an international perspective, the Financial Stability Board (FSB), under the umbrella of the G20, and standard setting bodies are taking stock of the regulatory and supervisory lessons learned from the recent turmoil in the banking sector.
- FSA will also actively contribute to international discussions and appropriately implement responses while taking into consideration such international discussions.

(Monitoring in Japan)

- Looking into Japan's financial system, at present, Japanese financial institutions, including regional banks, generally have substantial liquidity and capital, and the financial system as a whole is assessed to be stable. At the same time, domestic and foreign financial markets and economies are globally interconnected. Needless to say, the recent turmoil in other countries is not somebody else's problem, and the FSA will monitor recent developments with due attention.
- From the financial institutions perspective, it is important to make efforts as business as usual to ensure adequate liquidity and capital to prevent credit concerns. Last month, I directly asked the top management of each financial institution to establish an effective risk management framework that would enable them to respond flexibly and rapidly to sudden changes in the market. The FSA will continue to closely monitor the status of such risk management at each bank.

(Safety net)

- On top of this, Japan has built up a robust safety net based on the experience of the financial crisis since the late 1990s. First of all, under the deposit insurance system, deposits in general are protected up to a maximum of 10 million yen in the event of the failure of the bank, while corporate deposits for payment and settlement purposes are protected in full.

- Moreover, the financial safety net has been improved to prepare for and address the concern of financial stability. Specifically, i) capital injection under the Deposit Insurance Act and ii) flexible liquidity provision by the Bank of Japan (BOJ).

  Firstly, as a response to systemic risk, the Deposit Insurance Act allows the government to inject public funds into solvent but undercapitalized financial institutions as a precaution. The crisis management framework under the Deposit Insurance Act, including this recapitalization, is derived from legislations enacted during the height of Japan's financial crisis. Looking back, as a Deputy Director of the Ministry of Finance, I also contributed to these legislations, pulling many all-nighters. In addition to the recapitalization, these legislations also provide for key measures, such as the bridge bank and temporary nationalization. These legislations have formed the basis of the current banking safety net in Japan and resolution scheme for fighting financial crises.
- Second is about the liquidity provision framework. In normal times, the BOJ provides liquidity to market and financial institutions in response to liquidity needs through market operations and a complementary lending facility requested by financial institutions. Furthermore, in times of crisis, as the lender of last resort, the BOJ is able to provide funds to financial institutions short of liquidity.
- In addition, with the aim of revitalizing regional economies, the Act on Special Measures for Strengthening Financial Functions enables the government to inject public funds into financial institutions through the DICJ.

(Closing)

- In conclusion, I believe that now is a very appropriate time to hold this conference, bringing together experts and experiences from deposit insurance corporations and other organizations all over the world. I sincerely hope that fruitful discussions on the meeting will contribute to building a more sound and resilient global financial system. Thank you very much for your attention.