Bank of Japan

Mr. Daniel K. Tarullo
Board of Governors of the Federal Reserve System

April 28, 2012

Dear Mr. Tarullo,

The Bank of Japan welcomes the opportunity to share its concerns about the Single-Counterparty Credit Limits imposed on systemically important US financial institutions, as proposed by the Federal Reserve. We appreciate your efforts to enhance the resilience of the US financial system as a whole. We are aware that the ongoing discussion on the rule aimed at reducing the systemic risk incurred by some institutions is part of such efforts as required by the Dodd-Frank Act. Nevertheless, in a globalized and highly-interconnected financial circumstance, the proposed rule could have unintended impacts on non-US financial systems, much in the same way as the Volcker rule might do.

As for the Single-Counterparty Credit Limits, we would like to raise two specific areas of concerns:

- potential impact on the conduct of monetary policy as well as on the payment and settlement via central bank accounts; and
- potential impact on the market liquidity of non-US high-quality sovereign debts.

Referring to the first point, as the exposure to a foreign central bank might be counted as part of the credit exposure to the central government under the proposed rule, US financial institutions subject to the rule might not be able to maintain sufficient amounts of reserves in their current accounts with foreign central banks. In Japan, the counterparties of the Bank of Japan in conducting money market operations include a number of US financial institutions with current accounts with the Bank. The proposed rule therefore could reduce the effectiveness of the Bank's monetary policy conduct, and hamper the daily payments and settlements via the current accounts with the Bank.

On the second, extending the scope of credit limits to non-US sovereign debts could have a significant adverse impact on sovereign debt and related funding markets outside the United States, even if such debts are of high quality. Any consequent withdrawal, triggered by the breach of the limit, of US financial institutions from the activities in those markets could reduce market liquidity with incremental effects. It in turn would hinder the money market operations of central banks, especially the operations using sovereign debts as safe and liquid collateral assets. As the Federal Reserve must be fully aware, high-quality foreign sovereign debts play an important role in the local markets as do in the US markets US Treasuries, which are exempt from the proposed rule. We are all the more concerned with this issue, because US financial institutions are also the Bank's counterparties in the money market operations using Japanese government bonds.

We believe that the Federal Reserve, through constructive international dialogue, will find a creative and practical solution in achieving the goal of the Single-Counterparty Credit Limits as stipulated in the law, while avoiding unintended consequences. Our staff is most willing to cooperate and exchange views with your staff on the matter, should there be a need for more detailed discussion.

Yours sincerely,

Kenzo Yamamoto
Executive Director
Bank of Japan