(Tentative translation)
(Meeting item for the Sep. 17, 2021 Meeting)

[I]Report from the Sub-Group on Loans

- The chair of the Committee reported and shared with the members at the meeting held on April 27, 2021, that the Sub-Group on Loans and the Sub-Group on Bonds would start their concrete discussions on legacy contracts that cannot feasibly be transitioned away from LIBOR, also referred to as "tough legacy" contracts, in order to contribute to the orderly transition away from LIBOR.
- Subsequently, the Sub-Group on Loans has been making progress in necessary considerations by, for example, consulting with its members on (1) the basic idea of tough legacy contracts for which the adoption of synthetic yen LIBOR may be considered and (2) points to note when adopting synthetic yen LIBOR, in loan contracts referencing Japanese yen LIBOR (JPY) under the governing Japanese law.
- The Sub-Group considered the objective and significance of the discussions to be as follows.
  - It is important for the Committee to continue encouraging market participants to actively transition away from LIBOR in accordance with the roadmap.
  - On the other hand, synthetic yen LIBOR could be considered as a safety net for tough legacy contracts.
  - However, contracting parties should be aware of litigation risks, as synthetic yen LIBOR will be available only for one year, and it will not be feasible for synthetic yen LIBOR to replicate precisely the economic value of contracts referencing panel-based LIBOR and to sustain homogeneity with panel-based LIBOR.
  - Therefore, it is deemed valuable in terms of an orderly transition away from LIBOR that the Committee deliberates and shares with a wide range of market participants the basic idea on specifying tough legacy contracts for which synthetic yen LIBOR may be adopted and points to note when individual contracting parties consider the adoption of synthetic yen LIBOR in their tough legacy contracts.

    —— These points have been discussed with the Sub-Group on Bonds and it has been confirmed that the two sub-groups shared the common views on the objective and significance of their discussions.

- The members of the Sub-Group have reached a consensus on the following points. The Sub-Group would like to ask the Committee to discuss and summarize them in a public consultation in the coming weeks and seek an understanding from market participants.

(1) Definition of tough legacy contracts for which the adoption of synthetic yen LIBOR may be considered

✓ The following points constitute the basic idea to specify tough legacy contracts for which the adoption of synthetic yen LIBOR may be considered.

i. Way of thinking

➢ Loan contracts are considered negotiable in terms of making changes because it is easy to specify the contracting parties. Based on such features of the loan contracts as well as the limited time left before the cessation of JPY LIBOR, tough legacy contracts are defined as contracts that fulfill the following conditions.

Tough legacy contracts are contracts in which the relevant parties are unable to reach an agreement through either an active conversion to alternative reference rates or an insertion of robust fallback provisions by the end of 2021, despite financial institutions providing explanations and discussions in good faith being held among the parties involved to transition away from JPY LIBOR..[1]

ii. Discussions among the contracting parties

➢ Each contracting party is expected to follow the points below in the discussion mentioned above.[2]

Lenders: to communicate with clients in good faith and in a careful manner to prevent conduct risks Borrowers: to respond to the explanations and contract negotiations with financial institutions in good faith, taking market practices into account

[1] Tough legacy contracts in syndicated loans point to the contracts in which the relevant parties are unable to reach an agreement, after the agent bank and each participant bank have decided on the guidelines and the participant bank and the borrowers have discussed such guidelines.

In cases where an agreement cannot be reached (or it is unlikely for an agreement to be reached) before December 31, 2021, the relevant parties are not prevented from continuing with discussions until the next revision of interest rates, in order to avoid the use of synthetic yen LIBOR. Furthermore, if the relevant parties are unable to reach an agreement, it is important to consider risks of delays in interest payments for loan contracts, which might occur on the date of the first revision of interest rates after the end of 2021.

[2] In particular, in syndicated loans, all of the contract parties do not need to reach an agreement, as a greater number of parties are involved in syndicated loan contracts compared to other loan contracts and the scope of a "contracting party" may differ.

As for structured loans used as investment products, there are cases where the borrowers (including securities companies and trust banks) need to consider conduct risks and act on their own initiatives.

- ➢ Lenders should explain the following points to the borrowers.[3] When doing so, lenders (financial institutions) should be fully aware of the possibility of a conflict over abuse of dominant bargaining position under the Banking Act.

> - a summary of the permanent cessation of LIBOR, as well as risks and impact posed by the cessation
>
> - pros and cons of adopting each of the alternative interest rate benchmarks (fallback rates) and the spread adjustment methodologies recommended and presented in the results of the public consultations held by the Committee with regard to the options of alternative interest rate benchmarks in the active conversion and fallback provisions[4]
>
> - the fact that there would be no impact on future transactions with or without an agreement on an active conversion or fallback provisions
>
> - risks of a delay in interest payments, because there would be no interest rate benchmarks to reference if neither an active conversion nor robust fallback provisions is introduced before the cessation

iii. Specifying tough legacy contracts for which the adoption of synthetic yen LIBOR may be considered

- ➢ Contracting parties should specify tough legacy contracts based on (i) and (ii) mentioned above and consider using synthetic yen LIBOR as an alternative.[5] The decision on whether a synthetic yen LIBOR would be used after the end of 2021 should be made after the content of each contract has been considered and opinions of each contracting party involved and points mentioned in (2) below have been taken into account.[6]

(2) Points to consider when using synthetic yen LIBOR

✓ The following are the points that contracting parties should keep in mind when using synthetic yen LIBOR.

- ➢ There are several risks contracting parties need to be aware when using synthetic yen LIBOR. In particular, litigation risks should be taken

[3] Each financial institution can change their explanations depending on factors including the level of understanding among clients and the progress in preparation by financial institutions. Some financial institutions are expected to explain the points to consider in practice if deemed necessary (such as the change in the timing of decision-making for interest payments and other points regarding the accounting and taxes).
[4] Financial institutions are also expected to explain the quantitative points including the rate levels of alternative benchmarks.
[5] Financial authorities would confirm how synthetic yen LIBOR is being used and how customer services are being provided.
[6] This report does not prohibit the use of synthetic yen LIBOR in the contracts that are excluded from the scope of tough legacy contracts in the discussion.

into account, as the reference rate will be available only for one year, and it will not be feasible for synthetic yen LIBOR to replicate precisely the economic value of contracts referencing panel-based LIBOR and to sustain homogeneity with panel-based LIBOR.

- Contracting parties that adopt synthetic yen LIBOR should share a common understanding on the following points in advance to reduce litigation risks.[7]

- adopting a synthetic yen LIBOR instead of the current JPY LIBOR (panel-based LIBOR)
- adopting a synthetic yen LIBOR on the date of the first revision of interest rates after the cessation of the panel-based LIBOR
- the fact that it will not be feasible for synthetic yen LIBOR to replicate precisely the economic value of contracts referencing panel-based LIBOR, as synthetic yen LIBOR will be produced using a different methodology that is not reliant on panel bank submissions
- the fact that synthetic yen LIBOR will be available only for one year from January to December 2022, and that the contracts set to expire on and after January 1, 2023, will need to be negotiated again regarding the interest conversion in good faith and an agreement must be reached with regard to the alternative reference rate within a year (excluding contracts for which the interest rates referenced will not be revised on and after January 1, 2023)

―― However, litigation risks could continue to exist even after the measures noted above are implemented, including the shared recognition among the parties involved. Therefore, contracting parties are expected to transition from synthetic yen LIBOR to an alternative benchmark as soon as practicable after the end of 2021.

- Furthermore, each contracting party that is considering the use of synthetic yen LIBOR needs to consult with their lawyers on the methods for mitigating litigation risks and taking these measures accordingly.[8] In addition, it is preferable for the parties involved to keep record of the evidences for the measures taken to mitigate litigation risks.

- In addition to the points mentioned above, it is also desirable for contracting parties to take hedge accounting/tax measures when using

[7] Financial institutions should be fully aware of the possibility of a conflict with the abuse of dominant bargaining position under the Banking Act. They are also expected to keep record of the evidences used in negotiations to explain the use of synthetic yen LIBOR to the financial authorities, such as the circumstances where an agreement on either an active conversion or fallback provisions could not be reached, matters shared among the contracting parties, and additional measures implemented to reduce risks.

[8] For example, the lender could keep the record of evidences in the form of, for example, a written record on sharing a common understanding on (a) adopting a synthetic yen LIBOR as an alternative reference rate, and (b) adopting a synthetic yen LIBOR on the date of the first revision of interest rates after the cessation of the panel-based LIBOR.

synthetic yen LIBOR.

- During the period of the public consultation, the Committee is expected to consult on the following points with a wide range of market participants. Discussions will be proceeded based on the risks mentioned above and the fact that LIBOR should be actively transitioned away as soon as practicable before the end of 2021.
  - Whether there are any special circumstances where proceeding with the transition away from LIBOR may be inappropriate, taking account of potential risks of and uncertainties over inevitable delays in the achievement of milestones for the transition going forward, from the perspective of protecting clients and maintaining the integrity in financial markets and system.
  - Whether there is a surplus or deficiency in the significance of sharing a common understanding, details, and measures when using synthetic yen LIBOR.