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

[II]Report from the Sub-Group on Bonds

- 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 Bonds 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 bond contracts referencing Japanese yen (JPY) LIBOR 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 Loans 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

➢ Bond contracts have procedures for amending the contracts specified by law. Based on such features of bond 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 parties involved are unable to reach an agreement designated by law and to transition away from JPY LIBOR (an active conversion to alternative reference rates or an insertion of robust fallback provisions) by the end of 2021, despite the issuer's efforts to amend the contracts either through a convocation of bondholders' meetings or by obtaining the consent from all of the bondholders as specified by law.[1]

ii. Transition based on the procedures for amending the contracts

➢ Each contracting party is expected to follow the points below in the procedures of modifying the details of their contracts specified above.[2]

> Issuers: to try to provide explanation to the bondholders in good faith and in a careful manner
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> Bondholders: to respond to the explanations provided by the issuers in good faith

➢ Issuers should explain the following to the bondholders.[3]

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[1] In case of a transition away from JPY LIBOR through a convocation of bondholders' meetings, it refers to calling such meetings in accordance with the law.
If an agreement cannot be reached before December 31, 2021, the relevant parties will not be prevented from continuing with discussions until the next revision of interest rates.

[2] Securities companies can provide the explanations as sales companies, on behalf of the issuers. In case of discretionary fallback provisions, the relevant entities, issuers, and bondholders could communicate, with a view to exercising the discretionary power smoothly.

[3] Each issuer can change their explanations depending on factors including the level of understanding among bondholders and the progress in preparation by issuers. Some issuers 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).

- 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]
- risks of delays 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 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 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]

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4 Issuers 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 if deemed necessary.
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.
7 Financial institutions are expected to keep record of the evidences used in negotiations such as the circumstances where an agreement could not be reached via either an active conversion or

- 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 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 interest conversion for contracts set to expire on and after January 1, 2023, will need to be negotiated again 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)

- Litigation risks are involved in the use of synthetic yen LIBOR. To avoid such risks, the use of synthetic yen LIBOR requires an agreement between contracting parties to amend the contracts based on the procedures specified by law.

- On the other hand, an agreement is considered unlikely to be reached on the use of synthetic yen LIBOR when the parties involved are unable to obtain consent on an active conversion to alternative reference rates or an insertion of robust fallback provisions as required by law. In such a case, the relevant parties may implement measures to share the recognition even if they are unable to reach an agreement, to mitigate litigation risks in using synthetic yen LIBOR.

  —— These measures to share the recognition include, for example, (i) issuing a notice that includes the "negative consent" procedure, (ii) issuing a notice in the form of a written notice to convene a bondholders' meeting, and (iii) receiving the acknowledgement of receipt from the bondholders in addition to issuing a notice to them.[8]

- However, litigation risks could continue to exist even after the measures noted (i) to (iii) to share the recognition among the relevant parties are implemented. Therefore, contracting parties are expected to transition away from synthetic yen LIBOR to an alternative benchmark as soon as practicable after the end of 2021.

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fallback provisions, the content shared among the contracting parties, and additional efforts made to reduce risks so that they will be able to explain the use of synthetic yen LIBOR to the financial authorities.

[8] The "negative consent" procedure, in which provisions such that "proposals shall be deemed consented to unless the counterparty sends a notice rejecting it" within a certain period.

- To mitigate litigation risks, 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 if deemed necessary and to take measures based on the content of each contract and the intention of the contracting parties. Moreover, keeping record of the evidences for the measures taken is also considered to contribute to mitigating litigation risks.

- In addition to the points mentioned above, it is also desirable for contracting parties to take hedge accounting/tax measures when using 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, for example, from the perspective of protecting clients and maintaining the integrity in financial markets and system in Japan, in the achievement of milestones for the transition proceeded by the relevant parties.

  - Whether there is a surplus or deficiency in the significance of sharing a common understanding, details, and measures when using synthetic yen LIBOR.