This English translation is provided exclusively as a convenience. If any questions should arise related to the accuracy of the information contained in the English version, please refer to the official version of the document in the original language.

# Second Public Consultation on the Appropriate Choice and Usage of Japanese Yen Interest Rate Benchmarks

## — Considering the developments since the publication of the final report on the results of the last public consultation —

*August 2020*

*Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks*

## Contents

## 1. Introduction

In July 2019, the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (referred to simply as "Committee" hereinafter) launched the first public consultation on the basic approach toward the appropriate choice and usage of Japanese yen (JPY) interest rate benchmarks in order to deliberate on the preparation for the permanent discontinuation of LIBOR after the end of 2021. The Committee published the results of the public consultation in November 2019.[1] Since then, the Committee has deliberated on practical issues considering the results of the public consultation as well as discussions in the banking and securities industries and global developments.

The purpose of this public consultation is to present the results of the Committee's deliberations and to solicit comments on specific matters to be dealt with when fallbacks are triggered in cash products referencing JPY LIBOR from a wide range of market participants.

### (Global developments)

In the midst of the COVID-19 pandemic, in March 2020, the Financial Conduct Authority (FCA) of the United Kingdom, the Bank of England (BOE), and the Working Group on Sterling Risk-Free Reference Rates (RFRWG) issued a statement that firms could not rely on LIBOR being published after the end of 2021 and that end-2021 should remain the target date for all firms to meet.[2] In July 2020, the Financial Stability Board (FSB) also issued a statement that LIBOR transition was a G20 priority, reiterating that the FSB maintained its view that financial and non-financial sector firms should remove dependencies on LIBOR by the end of 2021 (Appendix 1-a).

In the meantime, significant progress has been made in actual practical operation; the International Swaps and Derivatives Association (ISDA) held a public consultation on pre-cessation triggers, which assumed fallback before the discontinuation of LIBOR.[3] In May 2020, the final report on the results of the public consultation was published, which supported simultaneously introducing permanent cessation triggers and pre-cessation triggers as measures

---

[1] For details on the past activities of the Committee, see the below link.
https://www.boj.or.jp/en/paym/market/jpy_cmte/index.htm/

[2] Meanwhile, in April 2020, considering the impact of COVID-19, the RFRWG released a statement that recommended all new issuance of sterling LIBOR-referencing loan products that would expire after the end of 2021 should cease by the end of Q1 2021.
https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfrwg-further-statement-on-the-impact-of-coronavirus-on-timeline-for-firms-libor-transition-plans.pdf?la=en&hash=68299592AF83B04E3BF60BA3209AA9A73522E9D4
In June 2020, the U.K. Government announced that it intended to bring forward legislation to amend the Benchmarks Regulation (BMR) to give the FCA enhanced powers. (See BOX1 for details.)

[3] https://www.isda.org/a/iioTE/2020-Consultation-on-Pre-Cessation-Issues-Final.pdf

to prepare for the possibility that LIBOR could become non-representative and vulnerable due to a decrease in the number of panel banks before the permanent discontinuation of LIBOR.[4] Consequently, regarding derivatives governed by the ISDA Master Agreement (referred to simply as "ISDA derivatives" hereinafter), the ISDA has nearly completed cross-currency deliberations and is currently working on the amendments to the 2006 ISDA Definitions and the preparations for the related protocol for legacy contracts referencing LIBOR that incorporate the amended 2006 ISDA Definitions.

The International Accounting Standards Board (IASB) finalized the amendments for Phase 1 in September 2019 which addressed the accounting issues before the benchmark replacement, and published the exposure draft of amendments for Phase 2 in April 2020 which addressed the issues on the benchmark replacement.[5] The exposure draft will be finalized in Q3 2020. The Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) to ease the potential burden in accounting for reference rate reform in March 2020.[6]

**(Domestic development)**

The Financial Services Agency of Japan (JFSA) and the Bank of Japan (BOJ) conducted a joint survey to identify financial institutions' quantification of LIBOR exposure and the number of contracts referencing LIBOR as well as financial institutions' progress toward transitioning away from LIBOR to alternative reference rates and their internal preparedness for this transition. In March 2020, the JFSA and the BOJ published the "Summary of Survey Results on the Use of LIBOR and Main Actions Needed."[7]

In addition, in June 2020, the JFSA and the BOJ wrote to the CEOs of major financial institutions regarding LIBOR transition in order to urge financial institutions to take actions for permanent discontinuation of LIBOR and to review the progress of preparedness in individual firms.[8]

With regard to the accounting issues arising from the benchmark reform, the Accounting Standards Board of Japan (ASBJ) released the Exposure Draft of Practical Solution on the Treatment of Hedge Accounting for Financial Instruments that Reference LIBOR (Exposure Draft

---

4 https://www.isda.org/a/cuQTE/2020.05.14-Pre-cessation-Re-Consultation-Report-FINAL.pdf

5 https://cdn.ifrs.org/-/media/project/ibor-phase-2/ibor2ed2020.pdf

6 https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176174318625&acceptedDisclaimer=true

7 https://www.boj.or.jp/en/announcements/release_2020/rel200313b.pdf

8 https://www.boj.or.jp/en/announcements/release_2020/rel200601b.htm/
Letters have been sent only to some financial institutions. However, the JFSA will monitor the preparedness of other financial institutions on the same basis as described in those letters.

of the Practical Issue Task Force, No. 59, referred to simply as "Exposure Draft" hereinafter) on June 3, 2020.[9]

## 2. Discussions in the Committee

Since the last public consultation, the Committee has deliberated on specific matters when fallbacks are triggered in bonds or loans referencing JPY LIBOR and the development of Term Reference Rates. The remainder of this report describes the discussions in the Committee.

### (Discussions on specific matters on fallbacks)

The U.S. and U.K. National Working Groups (NWGs) each held public consultations on spread adjustment methodologies for cash products referencing LIBOR. Both consultations concluded that the historical median approach over a five-year lookback period was supported, like in the case of the fallbacks for ISDA derivatives.[10] Furthermore, the U.S. National Working Group, the Alternative Reference Rates Committee (ARRC),[11] recommended a waterfall structure with Term Reference Rates as the first step, providing details such as sample fallback provisions for bilateral loans (Figure 2-1).[12]

Figure 2-1: Fallback rates recommended by the ARRC[13]

| | Fallback rates (methodology for spread adjustment[14]) |
|---|---|
| Step 1 | Term SOFR[15] (five-year historical median approach[16]) |
| Step 2 | Compounded SOFR (five-year historical median approach) |
| Step 3 | Relevant selected rate[17] |

---

[9] https://www.asb.or.jp/jp/accounting_standards/exposure_draft/y2020/2020-0603.html (Available in Japanese only.)

[10] For the results of the public consultation by the U.K. RFRWG, see the following link: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/consultation-on-credit-adjustment-spread-methodologies-for-fallbacks-in-cash-products-referencing-gb.pdf?la=en&hash=D893C0D56C992CBB0F4F3B7FAD1F2421F831DD85

For the results of public consultation by the ARRC, see the following link: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Spread_Adjustment_Consultation.pdf

[11] ARRC stands for Alternative Reference Rates Committee.

[12] https://www.newyorkfed.org/arrc/fallbacks-contract-language

[13] With regard to floating rate notes and securitizations, the ARRC sets the fourth step (ISDA fallback Rate) and the fifth step (Issuer or its Designee Selected Rate). With regard to syndicated loans, the Daily Simple SOFR is supported as the second step.

[14] The U.K. RFRWG deliberated on methodology for spread adjustment on the assumption of fallback to Sterling Overnight Index Average (SONIA) compounded in arrears or Term SONIA Reference Rates (TSRR). Consequently, the five-year historical median approach was supported.

[15] SOFR stands for Secured Overnight Financing Rate.

[16] Historical data are calculated based on Compounded SOFR.

In Japan, the Japanese Bankers Association (JBA) released "sample fallback provisions for bilateral loans" in March 2020 to help contracting parties amend the contracts for bilateral business loans that referenced JPY LIBOR in a smooth and efficient way.[18] Going forward, the JBA plans to update the sample fallback provisions considering the discussions in the Committee.

Also, the Japan Securities Dealers Association (JSDA) established the "Discussion Group on Interest Rate Benchmark Transition" (referred to simply as "Discussion Group" hereinafter), which consisted of the main Association Members engaged in bond transactions in December 2019 and has discussed practical issues such as standardized fallback provisions for bonds referencing JPY LIBOR and methodologies for spread adjustment.

**(Initiatives for the use of alternative reference rates)**

The Cross-Currency Swaps Subgroup of the ARRC deliberated on conventions in interdealer markets for cross-currency basis swaps, which are a type of the derivatives. The ARRC released the final recommendations in January 2020, proposing that the conventions be based on O/N RFR Compounding (Fixing in Arrears).[19] It is expected that interdealer cross-currency basis swap transactions will be carried out based on those conventions.

The Committee determined that QUICK Corp. was suitable as a calculating and publishing entity of prototype rates for Term Reference Rates, which received the most support as alternative rates for JPY LIBOR cash market products in the public consultation. QUICK Corp. began publishing prototype rates on May 26, 2020.[20] In Phase 1, it is assumed that the "prototype rates" will be used for market participants and end users to develop administrative systems and other measures in advance, while in Phase 2, "production rates," which are assumed to be actually referenced in contracts, will be published no later than mid-2021.[21]

The Committee has deliberated on specific matters when fallbacks are triggered in cash products (loans and bonds) referencing JPY LIBOR as well as held discussions on improving the robustness of Term Reference Rates, considering developments in national and international discussions concerning interest rate benchmarks.

---

[17] The rates for bilateral business loans are selected by the lender. The rates for syndicated loans are selected by the borrower and the administrative agent. The rates for floating rate notes and securitizations are both selected by the governmental body.

[18] https://www.zenginkyo.or.jp/news/2020/n033102/ (Available in Japanese only.)

[19] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Press_Release_Cross-Currency_Conventions.pdf

[20] https://moneyworld.jp/page/qtrf001.html

[21] For the methodology for calculating Term Reference Rates, see BOX 2.

## (1) Fallbacks in loans

The Committee discussed (i) replacement benchmarks and (ii) spread adjustment methodologies for fallbacks in loans referencing JPY LIBOR. The Committee would like to recommend the adoption of the results of its deliberations as shown below in order to encourage contracting parties to proceed with actual operations, taking into account the "end-2021" time limit.[22]

### (i) Replacement benchmarks

As a result of the public consultation held by the Committee last year, Term Reference Rates were most supported as the replacement benchmark for loans referencing JPY LIBOR, followed by TIBOR.

Meanwhile, as described above, progress has been made for actual operations: "sample fallback provisions for bilateral loans" (available only in Japanese) released by the JBA; and Term Reference Rates (prototype rates) published by QUICK Corp. However, both borrowers and lenders indicated the necessity of further discussion on replacement benchmarks in order to proceed with their contract negotiations.

The members of the Sub-Group on Loans were consulted on replacement benchmarks, taking into account global discussions and progress in the discussion on spread adjustment methodologies as described below in (ii), the results of which were subsequently examined by the Committee. It was found that, regarding replacement benchmarks for JPY LIBOR, a majority of respondents supported the waterfall structure shown in Figure 2-2, taking into account the consistency with global discussions and market participants' preference for alternative benchmarks based on RFRs.

[22] The replacement benchmarks and spread adjustment methodologies for loans recommended in this consultation paper are those most favored by the Committee, assuming they are applied mainly to standard contracts. Therefore, the Committee shall not preclude contracting parties from concluding a contract with different content from that recommended here. When applying the recommendation to actual transactions, it is necessary to take into consideration the characteristics of products and the feasibility for the parties including with respect to administration.

Figure 2-2: Replacement benchmarks for loans

| | |
|---|---|
| 1st priority | Term Reference Rates |
| 2nd priority | O/N RFR Compounding (Fixing in Arrears) [23,24] |
| 3rd priority | The alternate rate of interest that has been selected by the Lender [giving due consideration to (i) any selection or recommendation of a replacement rate or the mechanism for determining such a rate by the Relevant Governmental Body or (ii) any evolving or then-prevailing market convention] |

## (ii) Spread adjustments methodologies

As a result of the public consultation held by the Committee last year, with regard to spread adjustments, a majority of respondents preferred the Historical Mean/Median Approach, like in the case of the public consultation held by the ISDA. Thereafter, the U.K. and the U.S. NWGs discussed spread adjustment methodologies applicable to either Term Reference Rates or to O/N RFR Compounding (Fixing in Arrears) as the replacement benchmark for loans and bonds.

Based on the outcomes of the discussions in the U.K. and the U.S. NWGs and initiatives taken in Japan such as releases of Term Reference Rates (prototype rates) and the Exposure Draft, the Committee discussed spread adjustment methodologies applicable to either Term Reference Rates or to O/N RFR Compounding (Fixing in Arrears) as the replacement benchmark.[25]

As a result of the deliberations, in the case where O/N RFR Compounding (Fixing in Arrears) is adopted as the replacement benchmark, considering consistency among different currencies and prior discussions on ISDA derivatives, the Committee deemed it appropriate to adopt the "historical median approach over a five-year lookback period" for calculating spread adjustments

---

[23] On the premise that the spread adjustment methodology applicable to TIBOR as the replacement benchmark would be established, the waterfall structure using TIBOR in the second priority was supported by some respondents mainly due to the compatibility with the current administration and systems and a consideration for developing administrative systems. It should be noted that, even if the Committee recommends the waterfall structure as shown in Figure 2-2, the Committee shall not preclude contracting parties from selecting waterfall structures other than that in Figure 2-2 including those using TIBOR or a single replacement benchmark. In addition, transition to TIBOR before the release of Term Reference Rates (production rates) could be an option in order to reduce the amount of contracts referencing LIBOR.

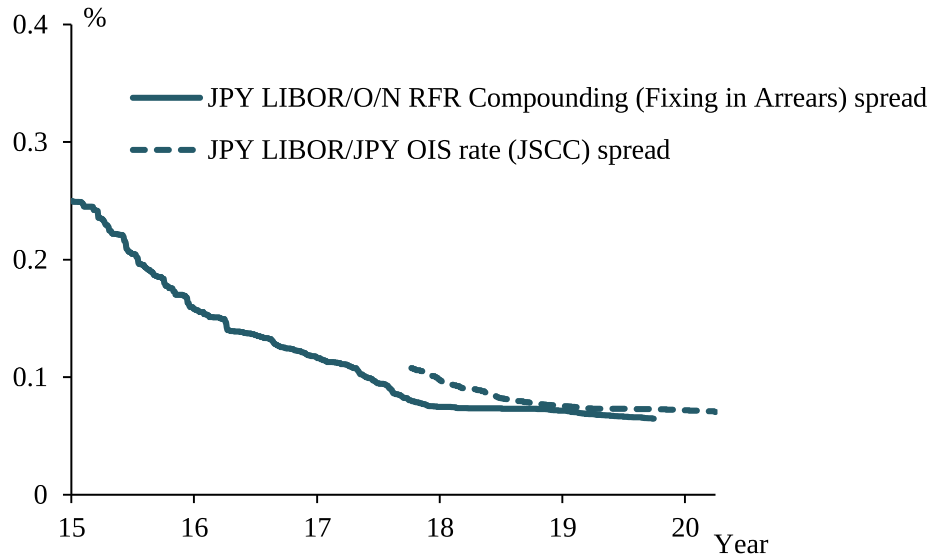
[24] Taking into account the discussion in the ARRC, the waterfall structure using a simple average of O/N RFR (Fixing in Arrears) in the second priority could be also considered.

[25] Regarding the case where TIBOR is adopted as the replacement benchmark, it was pointed out that, if the "historical median approach over a five-year lookback period" was selected as a spread adjustment methodology, the difference between the spread calculated by the historical median approach and the spread calculated based on derivative markets (for example, the LIBOR/TIBOR basis swap market) would be a critical issue. Taking account of this, there will be further discussions on this point.

between JPY LIBOR and O/N RFR Compounding (Fixing in Arrears) in terms of avoiding complicated calculation methodologies and of reflecting latest market trends.

On the other hand, in the case where Term Reference Rates are adopted as the replacement benchmark, one of the issues was that there were no historical data over a five-year lookback period, as the prototype rates of Term Reference Rates had just started to be published recently. To respond to this point, the sub-group examined the historical median over a five-year lookback period between (a) JPY LIBOR and the JPY Overnight Index Swap (OIS)[26] rate published by the Japan Securities Clearing Corporation (JSCC), and (b) JPY LIBOR and O/N RFR Compounding (Fixing in Arrears). As a result, it was confirmed that both medians were approximate (Figure 2-3).

Figure 2-3: Spread adjustments




(Notes) 1. The data used to calculate the historical median over the five-year lookback period are as follows.

- JPY LIBOR/O/N RFR Compounding (Fixing in Arrears): until the end of March 2020 (JPY LIBOR: until the end of September 2019)
- JPY LIBOR/JPY OIS rate (JSCC): until the end of March 2020 (JPY LIBOR: until the end of March 2020)

2. The historical median over the five-year lookback period for the JPY OIS rate (JSCC) is shown from October 2017 onward as the JPY OIS rate began to be published October 2012.

(Source) Bloomberg.

Therefore, even if Term Reference Rates are adopted as the replacement benchmark, the Committee deemed it appropriate to adopt the "historical median approach over a five-year lookback period" in order to calculate the spread adjustment between JPY LIBOR and O/N RFR Compounding (Fixing in Arrears).

[26] OIS stands for Overnight Index Swap.

With regard to spread adjustments used in actual contracts, the Committee deemed it appropriate to use Bloomberg's official spread data,[27] which would be used in ISDA derivatives, in terms of the consistency with other currencies and ISDA derivatives, and also ensuring neutrality and objectiveness.

In addition, if the "historical median approach over a five-year lookback period" is adopted, there is a possibility of a "difference" occurring in a level of spread adjustments compared to the case of adopting a methodology based only on the latest market trends. As a result, when JPY LIBOR is succeeded by a replacement rate, it is expected that a "difference" would be observed to some extent in the interest rate level after spread adjustments. However, the overseas NWGs and the ISDA decided to recommend the "historical median approach over a five-year lookback period," accepting such a "difference" existing, and the Committee agreed to recommend the same approach regardless of this issue (Figure 2-4).[28]

Figure 2-4: Spread adjustment methodologies deliberated by the Committee

| Products <Currency> | ISDA derivatives <LIBOR 5 currencies> | Cash products <GBP> | Cash products <USD> | Cash products <JPY> |
|---|---|---|---|---|
| NWGs | ISDA | RFR WG | ARRC | The Committee |
| Triggers | Permanent cessation triggers and pre-cessation triggers | | | Same as on the left |
| Spread adjustments | Historical median approach over a five-year lookback period | | | Same as on the left |
| Official spreads | Bloomberg-calculated ISDA fallback rates | | | Same as on the left |
| How to supplement any lack of historical data of Term Reference Rates | ——[29] | Use O/N RFR Compounding (Fixing in Arrears) | | Same as on the left |
| Transition period | Not needed | | | Same as on the left |

[27] The spread adjustments applied to fallback in ISDA derivatives were released by Bloomberg in July 2020. Depending on the users' type of business, the required license and fees for using the Bloomberg-calculated ISDA fallback rates would differ. For more details, see the FAQ published by Bloomberg below.
https://data.bloomberglp.com/professional/sites/10/Frequently-Asked-Questions-on-IBOR-Fallback-Adjustments_200721.pdf

[28] The Committee also discussed whether to set a transition period for mitigating the difference, and then deemed that it would not be necessary, because overseas NWGs and ISDA did not support one, administration would become complicated, and the impact of the difference would be limited.

[29] As O/N RFR Compounding (Fixing in Arrears) is adopted as the replacement benchmark, historical data are available and thus there is no need to consider this point.

## (2) Fallbacks in bonds

The Committee discussed (i) replacement benchmarks and (ii) spread adjustment methodologies for fallbacks in bonds referencing JPY LIBOR. The Committee would like to recommend the adoption of the results of its deliberations as shown below in order to encourage contracting parties to proceed with actual operations, taking into account the "end-2021" time limit.[30]

### (i) Replacement benchmarks

As a result of the public consultation held by the Committee last year, a large majority of respondents agreed that fallbacks for bonds referencing JPY LIBOR should be aligned with those for ISDA derivatives in order to maintain a hedge accounting relationship.[31]

Since then, progress has been made in several domestic areas such as accounting standards and global discussions (initiatives made by national working groups and authorities). In addition, for bonds, it is important that the fallbacks are standardized to some extent with a view to enhancing liquidity in the secondary market. Therefore, as described above, the Discussion Group comprising major securities companies has deliberated on the summary of fallback options for bonds.

Based on the deliberations of the Discussion Group, with a view to providing direction regarding fallbacks for bonds referencing JPY LIBOR, the members of the sub-group comprising not only securities companies but also investors and issuers were consulted, the results of which were subsequently discussed by the Committee. As a consequence, for the replacement benchmarks for straight bonds, the waterfall structure as shown below was supported (Figure 2-5).

---

[30] It is assumed that the recommendation in this consultation paper will mainly be applied to straight bonds, but it may be appropriate in some cases of securitizations and structured bonds to decide fallbacks depending on the nature of the products. Therefore, the Committee shall not preclude contracting parties from concluding a contract with different content in bonds, including straight bonds, from that recommended here. When applying the recommendation to actual transactions, it is necessary to take into consideration the characteristics of products and the feasibility for the parties including the administration of the contract.

[31] Regarding triggers, the ISDA published the final results of the consultation on pre-cessation fallbacks in May 2020 and introducing pre-cessation triggers was supported. In the case of straight bonds, it is considered appropriate to introduce not only permanent cessation triggers but also pre-cessation triggers, taking account of the aim to "align with the fallbacks for ISDA derivatives."

Figure 2-5: Replacement benchmarks for bonds

| | |
|---|---|
| 1st priority | Term Reference Rates |
| 2nd priority | O/N RFR Compounding (Fixing in Arrears) |
| 3rd priority | Rates recommended by the authority-related committee[32] |
| 4th priority | ISDA Fallback Rate |
| 5th priority | Rates selected by issuers |

### (ii) Spread adjustments methodologies

It was agreed in the Committee that it would be appropriate to adopt the same spread adjustment methodology for bonds as that for loans described in 2.(1)(ii).

## (3) Initiatives for enhancing the robustness of Term Reference Rates

The Committee discussed revitalizing JPY OIS, which is the underlying transaction of the Term References Rates, in order to make Term Reference Rates robust. Specifically, the members of the Sub-Group for the Development of Term Reference Rates, who participate in the interbank market, were consulted regarding the need for JPY OIS, the status of firm-led efforts to prepare, and the status of developing administrative and IT systems for JPY OIS, and then discussed next steps.

### (i) Need for JPY OIS

In the case that clients including borrowers on loans and issuers of bonds raised funds with referencing Term Reference Rates, Term Reference Rates followed by O/N RFR Compounding (Fixing in Arrears) were the most commonly cited as the assumed reference rates for the swaps (interest rate swaps and currency swaps) provided by the members (respondents) to fulfill the clients' demand to hedge their funding.

When respondents provided their clients with the swaps referencing Term Reference Rates (hereinafter "Term Reference Rates swaps"), it was confirmed that many of the respondents assumed that they would also reference Term Reference Rates in interbank transactions covering the swap transactions with their clients, from the perspective of reducing basis risks.

However, considering global discussions[33] and the fact that the Term Reference Rates swaps are not cleared by the JSCC at the moment, members embraced the idea that it would be

[32] It points to the committees recommended or convened by the central bank or the relevant authority.

important to enhance the robustness of Term Reference Rates in order to use them for transactions with clients.

Based on this idea, financial institutions are expected not only to increase the number of JPY OIS transactions, but also to (a) submit the quote data of JPY OIS proactively and (b) develop the related administration and IT systems.[34]

## (ii) Initiatives for revitalizing JPY OIS transactions

### a. Proactive engagement in submitting quote data

It was confirmed that many respondents had already submitted quote data for JPY OIS[35] including those with a specified notional amount. Meanwhile, approximately half of the respondents answered that the submission of quote data was "under discussion." Some were of the opinion that QUICK Corp.[36] and brokers should establish governance structures, and guidelines or other principles should be formulated on the responsibility of dealers who actually submitted quote data to brokers (Figure 2-6).

Figure 2-6: Status of submitting quote data for JPY OIS

| Status | Quote data without a specified notional amount | Quote data with a specified notional amount |
|---|---|---|
| (1) Already submitted every business day | 2 respondents | 1 respondent |
| (2) Already submitted (but not every business day) | 6 respondents | 5 respondents |
| (3) Plan to submit when Term Reference Rates are published on a daily basis | 1 respondent | 1 respondent |
| (4) Plan to submit within this year | 1 respondent | 1 respondent |
| (5) Under discussion | 9 respondents | 11 respondents |

[33] For example, the document released by the FSB described that the robustness of RFR-derived term rates would depend on liquidity in OIS markets, but activity in OIS markets might be relatively thin and therefore RFR-derived term rates could not equal the robustness of the overnight RFRs and thus RFR-derived term rates should be used only where necessary. There have been similar discussions in the United Kingdom and the United States.

[34] Institutional investors and non-financial corporates are also expected to develop measures including the administration and IT systems.

[35] Term Reference Rates are calculated based on the five-tier waterfall structure using JPY OIS data. Specifically, the framework places the first priority on executed transaction data and the second to fifth priorities on quote data, and then the higher prioritized data are used for calculation. See Supplement to Appendix 2-c of Public Consultation on the Appropriate Choice and Usage of Japanese Yen Interest Rate Benchmarks.

[36] QUICK Corp. is expected to meet the requirements of the Financial Instruments and Exchange Act, such as establishing governance structures, operation rules, and other guidelines and enhancing the transparency of the calculation procedure assumed, to be an administrator of Term Reference Rates. Once these preparations are complete, QUICK Corp. is expected to become an administrator.

Based on these opinions, in order to further encourage financial institutions to submit quote data, it is important to foster an environment where dealers could submit quote data without discomfort. It is expected that governance structures will be established mainly by QUICK Corp., which is assumed to become the benchmark administrator, in order to enhance the transparency of Term Reference Rates. In addition, dealer financial institutions are also expected to set up internal governance structures. Furthermore, it is considered important for the supervisory authority to provide appropriate support in order to establish governance structures for securing transparency.

### b. Development of the administration and IT systems for JPY OIS

The administration of interest rate swaps is roughly divided into four steps: (1) contracts at front offices; (2) confirmation at back offices; (3) taking counterparty credit risk, clearing, and notification of settlement amount by the JSCC; and (4) settlement. Administrative differences[37] between LIBOR swap and JPY OIS are summarized below (Figure 2-7).

Figure 2-7: Administration for LIBOR swap and JPY OIS

| | | LIBOR swap | JPY OIS |
|---|---|---|---|
| (1) Contract | | 2 business days before the start date of transactions | Same as on the left |
| (2) Confirmation of contract | | In principle, 2 business days before the start date of transactions | Same as on the left |
| (3) | Taking counterparty credit risk | By the start date of transactions | Same as on the left |
| | Transferring margin | Calculating margin on a daily basis and transferring on the next business day | Same as on the left |
| | Notification of settlement amount | 1 business day before the end date of calculation period | **Next** business day after the end date of calculation period |
| (4) Settlement | | End date of calculation period | **2** business days after the end date of calculation period |

On this point, it was confirmed that many respondents had already developed the administrative and IT systems for JPY OIS, and the others had started to examine the related issues. Some respondents claimed that they would need additional measures because the duration between (3)

[37] See Appendix 2-a for an outline of the administration for interest rate swaps.

notification of settlement amount and (4) settlement in the above chart was shorter than LIBOR swap. However, as a whole, it is unlikely that the administrative and IT systems will put constraints on the revitalization of JPY OIS.[38]

### (iii) Initiatives by QUICK Corp. based on market participants' requests

As a request to the supervisory authority, market participants claimed that it would be necessary to clarify the responsibility of dealer financial institutions, who submit quote data, through enhancing the transparency of the calculation procedure by QUICK Corp. in order to revitalize JPY OIS.[39]

In response, the supervisory authority indicated that it would be important to establish a governance structure focusing on that of QUICK Corp. and a clear calculation methodology of Term Reference Rates. Based on these requests from market participants, the "Task Force on Term Reference Rates" (hereinafter referred to as the "Task Force") established a roadmap for the publication of production rates planned to be developed by around the middle of 2021, in order to improve the quality of the underlying data of the benchmark (Appendix 2-b). The roadmap also included a schedule on the preparation for development of governance and for operation rules, which would lead to QUICK Corp. being designated as the "Specified Financial Benchmark Administrator."

---

[38] See footnote 34 above.

[39] With regard to the calculation of the benchmark, the scope of the authority's supervision under the Financial Instruments and Exchange Act is only the benchmark administrator, whereas the brokers, who provide data, and dealer financial institutions are not directly supervised.

## (4) Transition plan

The U.K. and the U.S. NWGs have published roadmaps for and the best practices related to the permanent discontinuation of LIBOR and have shared them with market participants.

"Next steps for LIBOR transition in 2020" announced by the U.K. RFRWG in January 2020 outlined key milestones such as ceasing issuance of GBP LIBOR-based cash products maturing beyond 2021 by end-Q3 2020 and switch of convention for sterling interest rate swaps from LIBOR to SONIA compounded (arrears).[40] In March 2020, an indicative roadmap outlining a path for the discontinuation of new Sterling LIBOR-based cash lending by end-Q3 2020 was published.[41] However, in April 2020, taking the impact of the COVID-19 pandemic into consideration, the U.K. RFRWG announced the change of the target for the discontinuation of all new issuance of sterling LIBOR-referencing loan products that expire after the end of 2021 from by end-Q1 2021 to by end-Q3 2020.[42]

In April 2020, the ARRC announced its key objectives, which included publishing a forward-looking term SOFR rate in the first half of 2021, establishing final recommended conventions for SOFR-based cash products, publishing a methodology of spread adjustments for fallbacks and publishing revisions to the ARRC's hardwired fallback language.[43] Thereafter, in May 2020, the ARRC announced best practices to assist market participants as they prepared for the discontinuation of U.S. dollar (USD) LIBOR, including the target for discontinuation of making new contracts referencing USD LIBOR.[44]

In response to these overseas developments and requests by market participants, the Committee has established a transition plan for cash products referencing JPY LIBOR maturing beyond 2021, which included a time frame (Figure 2-8). The transition plan included the following points: publishing the amended definitions and protocol (the ISDA), releasing the exposure draft of practical solution on the treatment of hedge accounting (the ASBJ), and publishing of the production rate of Term Reference Rates, and setting a target deadline of developing the system (the Japan Securities Depository Center). In addition, out of the measures needed to be prepared by each firm, the target deadline for (i) developing systems and operations for O/N RFR

[40] https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfrwgs-2020-priorities-and-milestones.pdf

[41] https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/path-for-discontinuation-of-new-sterling-libor-linked-lending-end-q3-2020.pdf

[42] See footnote 2 above.

[43] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_2020_Objectives.pdf

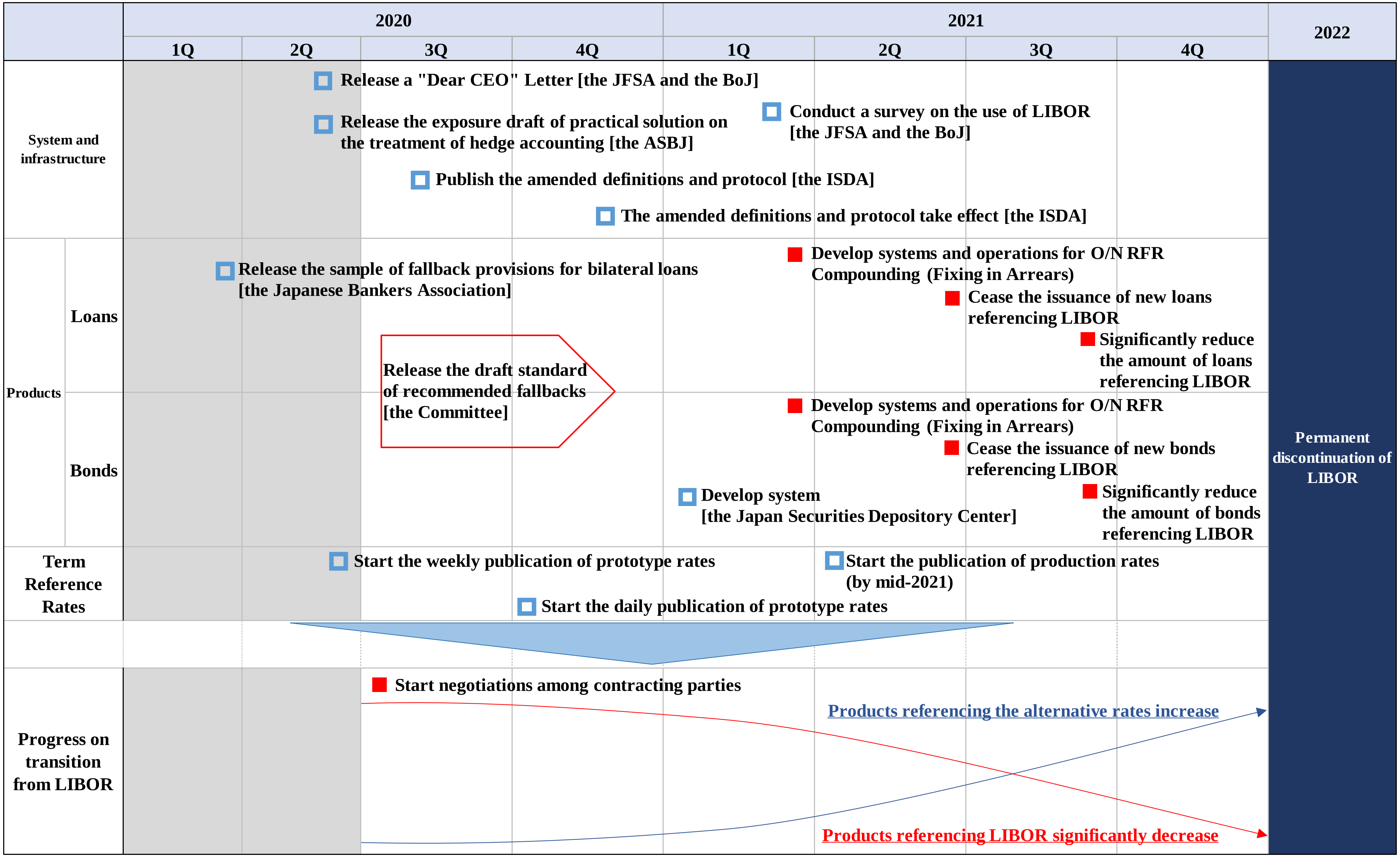
[44] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Press_Release_Best_Practices.pdf
https://www.newyorkfed.org/medialibrary/microsites/arrc/files/libor-timeline.pdf

Compounding (Fixing in arears), (ii) ceasing the issuance of new products referencing LIBOR, and (iii) significantly reducing the amount of products referencing LIBOR were indicated.[45]

The "Dear CEO" letters sent to financial institutions have required them to develop a transition plan and manage its progress with the proactive involvement of their management officers. The JPY LIBOR users including non-financial corporates are also required to proceed with necessary preparations in line with the transition plan set by the Committee.

[45] It should be noted that the items to be prepared for the discontinuation of LIBOR differ depending on the usage of LIBOR in each firm, and that the deadline indicated in this transition should be treated as one of the guidelines.

Figure 2-8: Draft Roadmap to Prepare for the Discontinuation of LIBOR




Note: ■indicates measures to be taken by each firm.

## 3. Issues subject to public comments

As described at the beginning, this public consultation document is intended to outline the outcome of past discussions in the Committee, and then solicit comments from a wide range of relevant parties on the fallbacks of JPY LIBOR.

In particular, in the midst of heightened concerns about the sustainability of LIBOR beyond the end of 2021, the volume of transactions in JPY LIBOR, a LIBOR quoted currency, is extremely large, and there is likely to be substantial effects on the various operations of JPY LIBOR users existing widely in Japan and abroad.

Accordingly, the Committee has decided to solicit comments on various issues mentioned in this public consultation document, and based on the results of this solicitation, publish the deliverables as the Committee.

Specific questions are shown in Appendix 3-a. Please provide your answers in accordance with (1) and (2) below.

### (1) Answering method

Answer format is provided in Appendix 3-b; please answer using it as appropriate.

Please note the following points when answering:

- Please answer assuming JPY as the denominated currency and Japanese law as the applicable law.
- Please base your answers on the external conditions (i.e., status of international discussions and the status of deliberation on hedge accounting) at the time.

### (2) Submission guideline

#### (i) Submission deadline

September 30, 2020

#### (ii) Submission address

Please send your comments and inquiries to the following address by email.

- Secretariat of the "Committee on Japanese Yen Interest Rate Benchmarks" (Market Infrastructure Group, Market Infrastructure Division, Financial Markets Department, Bank of Japan)

- post.fmd33@boj.or.jp

### (iii) Required information

- Your name (or the name of your organization)
- Contact information (telephone number and email address)
- Name of your organization (only if you belong to a corporate or any other type of organization)

### (iv) Notes

Information submitted, such as name, contact address, and other personal information, may be used to contact you to clarify and confirm information provided. Your comments may be published with your affiliation, unless specifically requested otherwise.

**BOX 1: Legislation announced by the U.K. Government regarding permanent discontinuation of LIBOR**

In June 2020, the U.K. Government announced that it intended to bring forward legislation to amend the Benchmarks Regulation (BMR) to give the FCA enhanced powers.[46]

The legislation will ensure that the FCA has the appropriate regulatory powers to manage and direct any wind-down period prior to eventual LIBOR cessation in a way that protects consumers and/or ensures market integrity. Specifically, in a case where LIBOR is no longer representative and would not be restored to representativeness, the FCA would be given enhanced powers (i) to require the administrator of LIBOR (IBA) to change the methodology for LIBOR, and (ii) to prohibit the use of LIBOR.

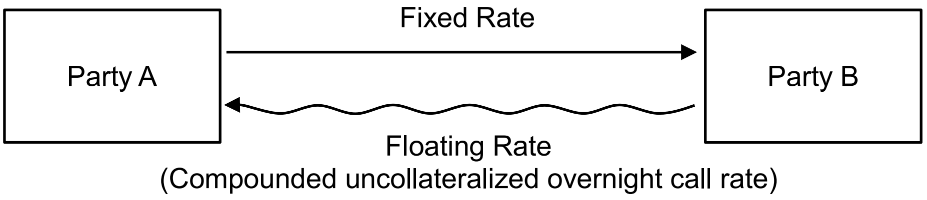
The U.K. Government and the FCA both emphasized that market participants should continue to focus on active transition.

[46] https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2020-06-23/HCWS307/

**BOX 2: Term Reference Rates**

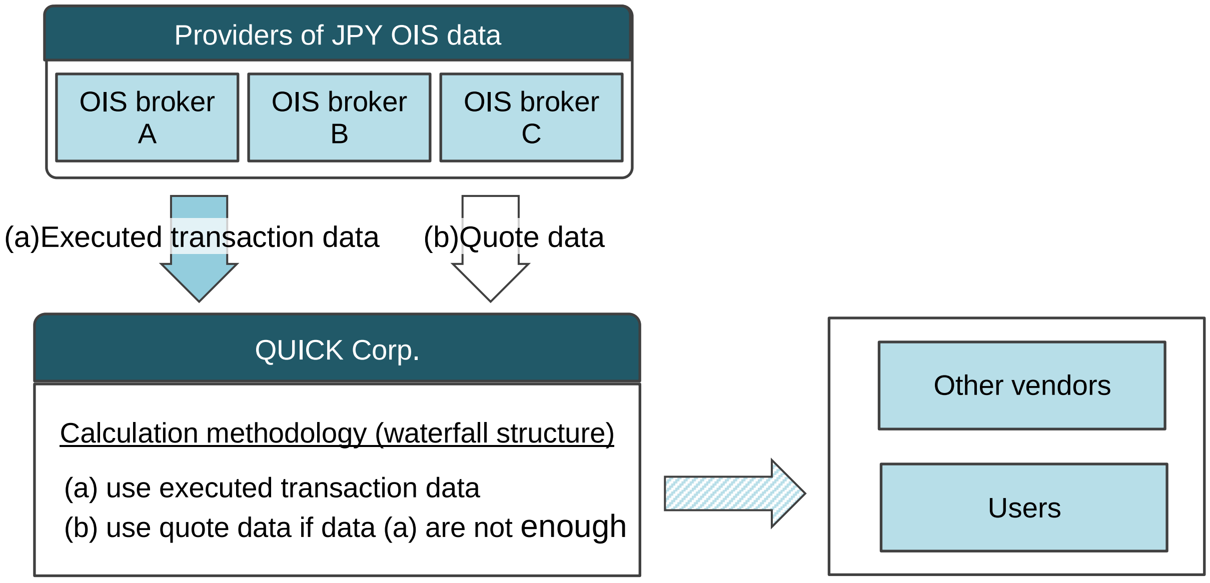
Term Reference Rates are calculated based on the data on JPY OIS. JPY OIS is a type of interest rate swap in which a floating rate calculated as the (compounded) weighted average of the uncollateralized overnight call rate for a certain period is exchanged for a fixed rate.

Figure B2-1: JPY OIS




The data of JPY OIS are provided by OIS brokers. The calculation methodology adopts a structure (waterfall), in which transaction data are used as priority if there are inputs of actual transactions and quote data are used if there is no input of actual transactions.[47]

Figure B2-2: Abstract of the Calculation and Publication Process for Term Reference Rates

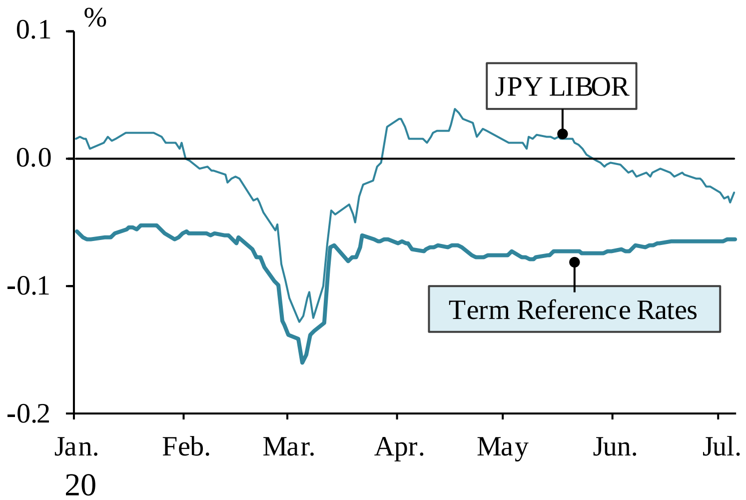



Trends in 6-month rates for the prototype rates of Term Reference Rates calculated with the methodology described above and JPY LIBOR are described below. The rate drops were observed from late February to early March 2020, when financial and capital markets became

[47] For details of the calculation methodology, see Appendix 2-c in the last consultation paper.

unstable due to COVID-19, but subsequently returned to their usual levels as market stability was restored by the policy measures of the central banks and governments.[48]

Figure B2-3: Trends in Prototype Rates of Term Reference Rates (6-month)




(Sources) QUICK Corp.; Refinitiv.

QUICK Corp. publishes the data of the prototype rates of the previous week on the second business day of each week, and plans to start daily publication around this autumn. It will also start the publication of production rates by mid-2021, developing its governance system based on the Financial Instruments and Exchange Act and the IOSCO Principles for Financial Benchmarks.[49]

For the publication of the production rates for Term Reference Rates, it is expected that the Task Force[50] will continue to provide QUICK Corp. with practical support on its initiatives described above.

---

[48] For developments in other currencies such as USD LIBOR, see Box 1 in the "Interim Financial Stability Report" (https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2020/may-2020.pdf) released by the BOE in May 2020, for example.

[49] In the U.K., four entities (ICE, IHS Markit, Refinitiv, and FTSE Russell) have shown interest in the development of TSRR, and ICE and FTSE Russell started the publication of prototype rates. FTSE Russell says the publication of a live rate that meets the requirements of the European benchmark regulation and the IOSCO Principles for Financial Benchmarks is targeted for the end of 2020.
・Rates published by ICE: https://www.theice.com/marketdata/reports/244
・Rates published by FTSE Russell: https://research.ftserussell.com/products/indices/tsrr

[50] The Task Force was established on August 28, 2019 to provide the calculating and publishing entities of Term Reference Rates with practical support and the members of the Task Force are taken from the small number of entities described below.
・Co-chairs of the Sub-Group for the Development of Term Reference Rates: MUFG Bank; Citigroup Global Markets Japan.
・Brokers of JPY OIS: Ueda Tradition Securities; Tullett Prebon (Japan); Totan ICAP.
・A non-financial corporate (interest rate benchmark user): Mitsubishi Corporation.
・An institution with knowledge of derivatives: the ISDA.
・An organization with knowledge of law and compliance: the Financial Law Board.
・The JFSA and the BOJ.

## Appendix 1-a: The FSB statement on the impact of COVID-19 on global benchmark reform [51]

1 July 2020

### FSB statement on the impact of COVID-19 on global benchmark reform

The Financial Stability Board (FSB) has discussed the impact of COVID-19 on global benchmark transition. The FSB's Official Sector Steering Group (OSSG) is monitoring the developments closely and recognises that some aspects of firms' transition plans are likely to be temporarily disrupted or delayed, while others can continue. The FSB maintains its view that financial and non-financial sector firms across all jurisdictions should continue their efforts in making wider use of risk-free rates in order to reduce reliance on IBORs where appropriate and in particular to remove remaining dependencies on LIBOR by the end of 2021.

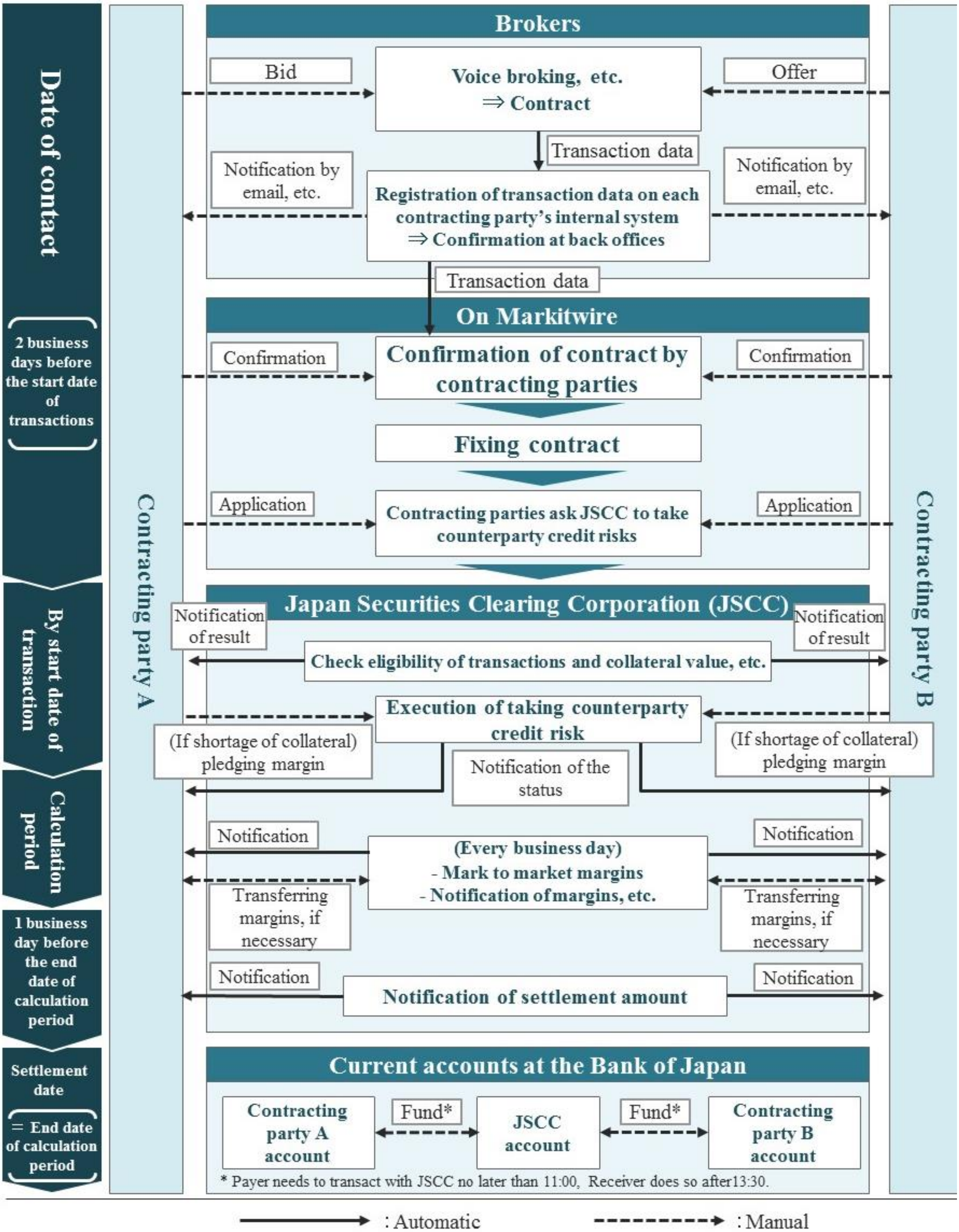
LIBOR transition remains an essential task that will strengthen the global financial system. COVID-19 has highlighted that the underlying markets LIBOR seeks to measure are no longer sufficiently active. Moreover, these markets are not the main markets that banks rely upon for funding. The increase in the most widely used LIBOR rates in March put upward pressure on the financing cost of those paying LIBOR-based rates. For those borrowers, this offset in large part the reductions in interest rates in those jurisdictions where central banks have lowered policy rates.

Relevant national working groups are co-ordinating changes to intermediate milestones in their benchmark transition programmes, where appropriate, to ensure global coordination. Financial and other firms should continue to ensure that their transition programmes enable them to transition to LIBOR alternatives before end-2021.

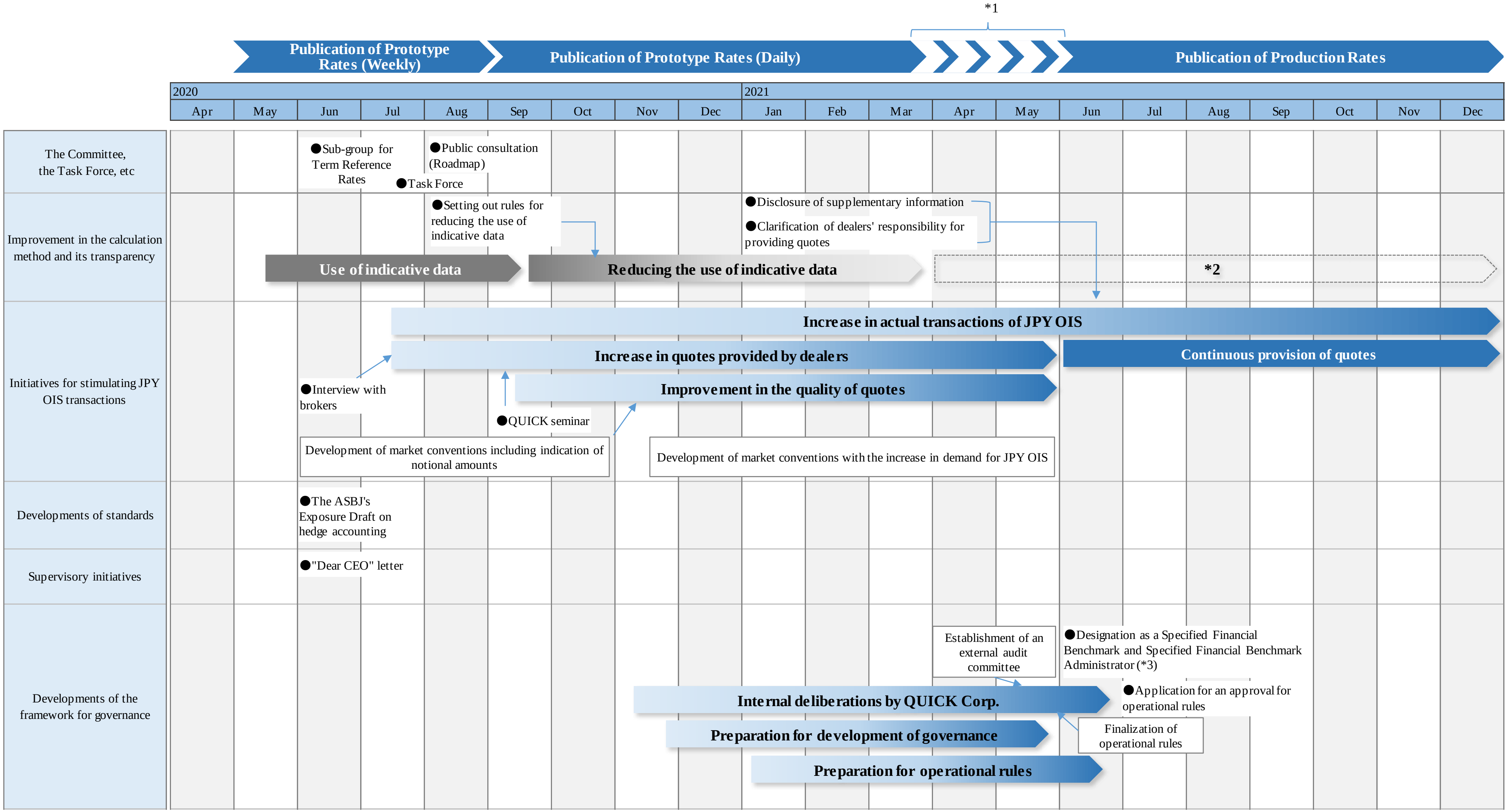
LIBOR transition is a G20 priority, and the G20 in its February 2020 communique asked the FSB to identify remaining challenges to benchmark transition by July 2020 and to explore ways to address them. The FSB will publish a report on these issues later this month. FSB members, in collaboration with other standard-setting bodies and international institutions, will continue to monitor developments.

[51] https://www.fsb.org/2020/07/fsb-statement-on-the-impact-of-covid-19-on-global-benchmark-reform/

## Appendix 2-a: Outline of administration for interest rate swaps



# Appendix 2-b: Schedule for publication of production rates for term reference rates




Note:

1. While QUICK Corp. seeks to publish production rates no later than mid-2021, the rates are also expected to be published earlier. In that case, the entire schedule will be moved up compared to the timeline shown above.
2. In principle, indicative data will be used only as a backstop in case of a system failure or natural disaster.
3. QUICK Corp. will work on necessary preparations for the use within Europe, along with preparations to comply with regulations regarding the Specified Financial Benchmark.

## Appendix 3-a: Issues subject to public comments

| Number | Relevant chapter, etc. | Subsection | Page | Question |
|---|---|---|---|---|
| 1 | 2.(1) (i) | Fallbacks in loans | P.6 | This question is about the benchmark replacement for loans. The Committee recommends the waterfall structure described in Figure 2-2 (page 7) as the replacement benchmark.<br>Please describe whether you agree or disagree and explain why. |
| 2 | 2.(1) (ii) | Fallbacks in loans | P.7 | This question is about the spread adjustment methodologies for fallbacks in loans. The Committee deemed it appropriate to adopt the methodologies described in Figure 2-4 (page 9).<br>Please describe whether you agree or disagree and explain why. |
| 3 | 2.(2) (i) | Fallbacks in bonds | P.10 | This question is about the benchmark replacement for bonds. The Committee recommends the waterfall structure described in Figure 2-5 (page 11) as the replacement benchmark.<br>Please describe whether you agree or disagree and explain why. |
| 4 | 2.(2) (ii) | Fallbacks in bonds | P.10 | This question is about the spread adjustment methodologies for fallbacks in bonds. The Committee deemed it appropriate to adopt the same methodologies as those for loans described in Question 2.<br>Please describe whether you agree or disagree and explain why. |
| 5 | 2.(3) | Initiatives for enhancing the robustness of Term Reference Rates | P.10 | This question is about the initiatives for making Term Reference Rates robust. The Committee deemed it essential to revitalize trading of JPY OIS, which is the underlying transaction of Term Reference Rates.<br>Please describe any issues that market participants should address to revitalize JPY OIS. |
| 6 | - | - | - | Please provide any other issues that may need to be deliberated other than the ones in the public consultation document. |