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Final Report on the Results of the Public Consultation on the Treatment of Tough Legacy Contracts in Japan

November 2021

The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks

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1. Introduction

(1) Background

The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (hereinafter referred to as the "Committee") published "Public Consultation on the Treatment of Tough Legacy Contracts in Japan"¹ (hereinafter referred to as the "public consultation paper"), where the Committee solicited opinions from a wide range of relevant parties in Japan and abroad from September 28 to October 19, with the expectation that this report will be regarded as a standard in Japanese markets for the treatment of legacy contracts that cannot feasibly be transitioned away from Japanese yen (JPY) LIBOR (i.e. so-called tough legacy contracts).

The public consultation paper summarized the views of the Committee with regard to (a) the concept of contracts that would fall under the category of tough legacy contracts in Japan and for which the use of synthetic yen LIBOR might be considered and (b) points to note when using synthetic yen LIBOR based on the developments surrounding the LIBOR transition in Japan and abroad, and solicited opinions regarding nine items described in the public consultation paper.²

(2) Developments after the publication of the public consultation paper

(Publication of synthetic LIBOR)

On September 29, the U.K. Financial Conduct Authority (FCA) published a series of documents on the publication of synthetic LIBOR.³ With these documents, the FCA confirmed its decision to require ICE Benchmark Administration (IBA), the administrator of LIBOR, to calculate and publish synthetic LIBOR for certain tenors of GBP LIBOR and JPY LIBOR. Synthetic yen LIBOR will be calculated as "TORF⁴ + ISDA spread (median of past 5 years)" and is expected to be published only for one year after the turn of 2022.

¹ For details, please refer to the following link.

https://www.boj.or.jp/en/paym/market/jpy_cmte/cmt210928a.pdf

² For details, please refer to 1.(1) of the public consultation paper.

³ <https://www.fca.org.uk/news/press-releases/further-arrangements-orderly-wind-down-libor-end-2021>

⁴ TORF is to be multiplied by 360/365, in order to adjust the difference between the convention of TORF and JPY LIBOR.

(Progress made in Japanese markets)

According to the "Roadmap to Prepare for the Discontinuation of Japanese Yen LIBOR"⁵ (hereinafter referred to as the "Roadmap") formulated by the Committee, existing contracts of loans and bonds referencing JPY LIBOR were expected to be reduced significantly by the end of September 2021. In this regard, the respondents of a survey conducted by the Committee in the middle of September viewed that an average of about 70 to 80 percent of existing contracts would be reduced by the end of September.⁶ Although it should be noted that the respondents were limited to the members of the Committee, the Committee confirmed that the transition has been progressed in line with the Roadmap.

Moreover, the Financial Services Agency of Japan (FSA) and the Bank of Japan (BOJ) jointly conducted "Brief Survey on the Use of JPY LIBOR" from September to October in order to grasp the current situation of the transition away from JPY LIBOR at major financial institutions in Japan, and released a summary of the results on November 1.⁷ The results also indicated that significant progress has been made in the areas of loans, bonds (liabilities), and derivatives as of the end of September 2021. The majority of contracts for which transition had not yet been completed as of the end of September are expected to transition away from JPY LIBOR by the end of December 2021. Although a small number of contracts may not complete their transition by the end of the year, exceptionally, the transition for these contracts is expected to be completed before the first interest payment or revision of interest rates after the turn of 2022, and there were no contracts that would fall under the category of tough legacy contracts and were expected to use synthetic yen LIBOR at the time of the response.

⁵ For details, please refer to Appendix 1.

⁶ The percentage of reduction is calculated based on the percentage of loan contracts and bond contracts referencing LIBOR as at the end of December 2020 that have taken measures to transition away from JPY LIBOR such as an active conversion or an insertion of fallback provisions by the end of September 2021.

⁷ (FSA) https://www.fsa.go.jp/en/news/2021/20211101/libor_survey_english_20211101.pdf
(BOJ) https://www.boj.or.jp/en/announcements/release_2021/data/rel211101c.pdf

(3) Purpose and objective of the report

The purpose of this report is to present the results of the public consultation as well as the views of the Committee and is intended to be regarded as a standard in Japanese markets for the treatment of tough legacy contracts and the use of synthetic yen LIBOR.⁸

As mentioned above, the Committee considers that steady progress has been made in the transition away from JPY LIBOR in Japanese markets and contracts for which synthetic yen LIBOR is expected to be used have not been specified at the moment. However, there is a possibility that tough legacy contracts will arise and synthetic yen LIBOR may be used as a "safety net" for these contracts.

The Committee believes that it is necessary to summarize the discussions on the use of synthetic yen LIBOR when tough legacy contracts arise for market participants to refer to, in order to support an orderly transition away from JPY LIBOR in Japan.

Nevertheless, contracting parties should take into account the content of each contract and intentions of the contracting parties when considering their transition. Although the contents of this report are expected to be referred to by a wide range of market participants, they will not preclude contracting parties from reaching an agreement that differs from what is presented in the report.

⁸ The subject of consideration in the public consultation paper and this report is existing contracts for loans and bonds that reference JPY LIBOR under the governing Japanese law. In addition, for transactions referencing USD LIBOR, GBP LIBOR, CHF LIBOR, and EUR LIBOR, responses must be made based on the timelines and guidance provided by the home authorities of each currency. It is expected that products that reference JPY LIBOR and are based on laws in other countries and regions will be subject to review in each jurisdiction.

2. Results of the public consultation

(1) Summary

A total of 38 entities from a wide range of industries such as financial institutions, institutional investors, and non-financial corporates provided their comments on nine items described in the public consultation paper (Figure 2-1). With regard to all items subject to comments, a large majority of respondents supported the deliberations made by the Committee.

Figure 2-1: Overview of respondents⁹

Total	Banks	Securities Companies	Institutional Investors	Non-financial Corporates	Others
38	12	12	6	6	2

This section describes the comments received on each item and the Committee's views on them.

(2) Tough legacy contracts that could consider using synthetic yen LIBOR

The Committee summarized the basic concept and requirements for specifying tough legacy contracts that could consider using synthetic yen LIBOR in the public consultation paper.

⁹ Industry groups are classified according to the type of industry that the constituent companies are in. Those consisting of multiple industries are classified as "Others." Please also note that a comment from each industry group is regarded as one opinion regardless of the number of members in the group. In addition, respondents that did not provide answers to some of the questions are included in the number of respondents (the same applies to the remainder of the report).

A. Basic concept (loans)

(i) Discussions in the public consultation paper and items subject to public comments

The public consultation paper described the basic concept for specifying tough legacy contracts that could be considered using synthetic yen LIBOR with regard to loan contracts as follows and solicited comments.

Discussions in the public consultation paper

Loan contracts are considered negotiable in terms of making changes because it is easy to specify the contracting parties. That being said, it is important for contracting parties to take into account the limited time left before the cessation of panel-based JPY LIBOR and conduct negotiations in good faith when they make changes to their contracts.

On the other hand, it is also possible that there are contracts that cannot be agreed upon even after such negotiations. For this reason, it has been deemed appropriate to consider contracts that fulfill the following conditions as tough legacy contracts.

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 provisions¹⁰ 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.^{11,12}

¹⁰ In the Committee's first and second public consultations, the hardwired approach, which falls back to the replacement rate determined upon the introduction of fallback provisions, had gained support from market participants. In addition, regarding the conditions on which fallback provisions (triggers) are activated, it was recommended by the Committee to introduce both permanent cessation triggers and pre-cessation triggers, and this recommendation has gained support from market participants.

¹¹ 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.

¹² The Committee recommends reaching an agreement by the end of 2021, when the cessation of panel-based JPY LIBOR will take place. If contracting parties are unable to reach an agreement by the end of 2021, it is considered preferable to continue with discussions until the day of the first revision of interest rates after the turn of 2022 and reach an agreement as early as possible.

However, in the above discussion, the contracting parties should pay particular attention to the following points with a view to promoting smooth discussions.¹³

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

(Points in common to loans and bonds)

In discussions and modification procedures between contracting parties, the following information should be explained to the borrower by the lender or to the bondholder by the issuer, for example, so that there is no misunderstanding about the purpose and content of the discussions and modifications.^{14,15}

- ✓ 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 provisions¹⁶
- ✓ 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

¹³ 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.

¹⁴ Each financial institution can change their explanations depending on factors including the content of individual contracts, the level of understanding among clients and the progress in preparation by financial institutions. Moreover, if bondholders' meetings are to be held, matters including the content indicated herein should be included in the reference documents for the meeting of bondholders and voting documents to be delivered to bondholders in accordance with the Companies Act, with a view to providing information to all bondholders in advance.

¹⁵ It is desirable for entities including financial institutions and issuers to consult with, for example, lawyers, as necessary, and to be able to explain the reasonableness of the extent of such explanation after the fact.

¹⁶ In the public consultation, opinions were received regarding the promotion of the use of the Tokyo Term Risk Free Rate (TORF), simplification of the handling of accrued and unpaid interests on O/N RFR Compounding (Fixing in Arrears), and license fees, in relation to alternative interest rate benchmarks and spread adjustment methods. Although all of these are outside the scope of this public consultation, the Committee expects relevant parties to proceed with deliberations as necessary.

When discussing the above in the context of loans, financial institutions should explain that future transactions will not be affected by whether there is an agreement or not on the introduction of an active conversion/fallback provisions and should pay careful attention to, for example, the fact that this may be considered abuse of dominant bargaining position under the Banking Act.

Items subject to public comments

As shown above, the Committee organized the concept of loan contracts that are considered to fall under the category of tough legacy contracts. Please describe whether you agree or disagree and explain why.

(ii) Opinions of respondents

As a result of the public consultation, a large majority of the respondents agreed with the views presented by the Committee (Figure 2-2).

Figure 2-2: Opinions of respondents on the basic concept (loans)

Agree	Disagree
32 respondents	2 respondents (1 non-financial corporate, 1 securities company)

Those who have agreed expressed views that it was desirable to organize the basic concept, as it would make it easier to determine whether or not a legacy contract would fall under the category of tough legacy contracts. They also expressed their support for the Committee's views, indicating that the views took into account characteristics and practical aspects of loan contracts, were consistent with the deliberations in Japan thus far and the general understanding overseas, and did not impose burdens on either the lender or the borrower. Another respondent indicated that it would be beneficial to encourage discussions between the contracting parties so that they would not easily resort to identifying contracts as tough legacy contracts.

On the other hand, those who have disagreed expressed views that there was a high possibility for the definition to lose its substance if the contracting parties were able to reach an agreement to use synthetic yen LIBOR, and that it was not desirable to discuss whether it would be possible to use synthetic yen LIBOR or not with an intention to limit or prohibit the use of synthetic yen LIBOR, especially for existing loan contracts, because it was a matter of private law.

(iii) Views of the Committee

The Committee expects the views presented by the Committee, which identified that the use of synthetic yen LIBOR can be considered for contracts that fall under the basic concept described in (i) above as tough legacy contracts, to be regarded as a standard in Japanese markets for the treatment of tough legacy contracts, and a wide range of market participants in Japan to proceed with their preparations for the transition in line with the results.

However, the use of synthetic yen LIBOR is not prohibited in cases in which an agreement is reached between the contracting parties, even if the contracts do not fall under the basic concept described in (i). The decision on whether or not to use synthetic yen LIBOR should be made by the contracting parties, based on the content of each contract and intentions of the contracting parties, taking into account the considerations outlined in the public consultation paper.

B. Basic concept (bonds)

(i) Discussions in the public consultation paper and items subject to public comments

The public consultation paper described the basic concept for specifying tough legacy contracts that could be considered using synthetic yen LIBOR with regard to bond contracts as follows and solicited comments.

Discussions in the public consultation paper

In many cases, bond contracts have procedures for amending the contracts specified by law.¹⁷ That being said, it would be important for issuers to take into account the limited time left before the cessation of panel-based JPY LIBOR and to work on the transition either through a convocation of bondholders' meetings or by obtaining the consent from all of the bondholders.

On the other hand, despite these efforts, there may be contracts for which the transition cannot be completed before the end of 2021. For this reason, it has been deemed appropriate to consider the contracts that fulfill the following conditions as tough legacy contracts.

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 provisions¹⁸) 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.^{19,20}

However, the contracting parties should pay particular attention to the following points, with a view to facilitating the above procedures.²¹

¹⁷ Structured bonds and securitized instruments are included in the bonds that have procedures to modify contracts specified by law; however, this report uses the terms "corporate bonds" and "bondholders" unless otherwise specified, taking account of corporate bonds under the Companies Act. With regard to bonds that do not fall under the category of corporate bonds under the Companies Act, the terms "corporate bonds" and "bondholders" in the text should be read as terms equivalent to "corporate bonds" and "bondholders" in the relevant laws and regulations.

¹⁸ Please refer to footnote 10.

¹⁹ 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.

²⁰ The Committee recommends completing the transition by the end of 2021, when the cessation of panel-based JPY LIBOR will take place. 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.

²¹ 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.

Issuers : to try to provide explanation to the bondholders in good faith and in a careful manner

Bondholders: to respond to the explanations provided by the issuers in good faith

(Points in common to loans and bonds)

This section is omitted as it is the same as "A. Basic concept (loans)."

Items subject to public comments

As shown above, the Committee organized the concept of bond contracts that are considered to fall under the category of tough legacy contracts. Please describe whether you agree or disagree and explain why.

(ii) Opinions of respondents

As a result of the public consultation, a large majority of the respondents agreed with the views presented by the Committee (Figure 2-3).

Figure 2-3: Opinions of respondents on the basic concept (bonds)

Agree	Disagree
32 respondents	2 respondents (1 bank, 1 securities company)

Those who have agreed expressed views that having the basic concept of tough legacy contracts organized would make it easier to determine whether or not a legacy contract would fall under the category of tough legacy contracts, and it would be useful in encouraging explanation by issuers to a large number of bondholders. They also commented on the Committee's views that they took into account the procedures and requirements that were necessary to change the terms of bond contracts. Moreover, some respondents indicated that it was important to hold discussions in good faith among the contracting parties especially with the limited time left before the end of 2021, and that it was inevitable for contracting parties to use synthetic yen LIBOR if an agreement could not be reached even after discussions in good faith.

On the other hand, those who have disagreed expressed views that, in relation to the fact that there had not been any cases of a convocation of bondholders' meetings for publicly offered bonds under the governing Japanese law in the past, (a) it was not appropriate to make the convocation of bondholders' meetings a necessary condition and (b) it might be difficult to convoke a bondholders' meeting and complete the transition before the day of the first revision of interest rates after the turn of 2022.

(iii) Views of the Committee

Regarding (a) and (b), many bond issuers are proceeding with their preparations for the transition away from JPY LIBOR, either through a convocation of bondholders' meetings or by obtaining the consent from all of the bondholders. The Committee believes that it is desirable to proceed with the transition in accordance with the procedures for amending the contracts specified by law.

As for (b), if contracting parties are unable to complete their transition by the end of 2021, it is considered preferable to continue with discussions so that they can reach an agreement as early as possible before the day of the first revision of interest rates after the turn of 2022. Nonetheless, for contracts that do not fall under the basic concept described in (i) above, contracting parties are not prohibited from using synthetic yen LIBOR as long as they are able to reach an agreement, as shown in the previous section (please refer to 2 [2] A.[iii] proviso).

C. Considering the use of synthetic yen LIBOR

(i) Discussions in the public consultation paper and items subject to public comments

The public consultation paper described the consideration on the use of synthetic yen LIBOR as follows and solicited comments.

Discussions in the public consultation paper

For contracts that fall under the basic concept mentioned above, the use of synthetic yen LIBOR may be considered as a "safety net," as there will be no interest rate benchmarks to rely on due to the cessation of panel-based JPY LIBOR.

In such cases, there are no laws and regulations in Japan that regulate the use of specific interest rate benchmarks, and individual contracting parties need to decide on whether or not to use synthetic yen LIBOR for tough legacy contracts, based on the content of the contracts and intentions of the parties concerned, taking into account the points to be noted.²²

Items subject to public comments

As shown above, the Committee concluded that the use of synthetic yen LIBOR could be considered for contracts that fall under the category of tough legacy contracts, after taking into account the content of the contract, litigation risks, and other considerations. Please describe whether you agree or disagree and explain why.

(ii) Opinions of respondents

As a result of the public consultation, a large majority of the respondents agreed with the views presented by the Committee (Figure 2-4).

Figure 2-4: Opinions of respondents on the consideration of the use of synthetic yen LIBOR

Agree	Disagree
33 respondents	1 respondent (1 securities company)

²² The FSA and the BOJ have indicated that they will check the status of the use of synthetic yen LIBOR and customer support as necessary. For more information, please refer to the following links.

(FSA) <https://www.fsa.go.jp/en/policy/libor/syntheticlibor202102.pdf>

<https://www.fsa.go.jp/news/r3/20210831/20210831.html> (available only in Japanese)

(BOJ) https://www.boj.or.jp/en/announcements/release_2021/data/rel210308a.pdf

Those who have agreed expressed views that the idea of using synthetic yen LIBOR for contracts that would fall under the category of tough legacy contracts was appropriate, from the perspective of synthetic yen LIBOR's role as a "safety net" as well as the possibility that certain contracts might fail to reach an agreement by the deadline. It was also pointed out that the proposal by the Committee would be the best way to balance between the need for synthetic yen LIBOR and the litigation risks associated with its use. Other respondents agreed with the proposal that contracting parties needed to decide on whether or not to use synthetic yen LIBOR, as there were no legislative measures for tough legacy contracts in Japan, that it was reasonable from the perspective of investor protection, and that there were no other viable options available.

On the other hand, those who have disagreed expressed views that (a) the decision of whether or not to use synthetic yen LIBOR should be discussed as a matter of private law regardless of the Committee's view. In relation to this point, even those who supported the Committee's view insisted that (b) the use of synthetic yen LIBOR should not be restricted as long as the content of the contract and litigation risks were recognized by the contracting parties. Another respondent noted that (c) if the Committee were to declare that synthetic yen LIBOR could not be used for contracts that would not fall under the category of tough legacy contracts, this declaration could activate triggers in fallback provisions of certain existing contracts.²³

(iii) Views of the Committee

With regard to (a) and (b), the Committee believes that tough legacy contracts that fall under the basic concepts indicated in A and B may be considered for the use of synthetic yen LIBOR. However, as mentioned previously, for contracts that do not fall under these concepts, contracting parties are not prohibited from using synthetic yen LIBOR, if they are able to reach an agreement (please refer to 2 [2] A. [iii] proviso).

²³ The respondent pointed out that some of the fallback provisions designated triggering events as cases in which contracting parties were prohibited from performing their obligations in transactions referencing LIBOR, based on the statements or declarations by relevant governmental bodies or relevant laws and regulations.

As for (c), for contracts that do not fall under the basic concepts described above, contracting parties are not prohibited from using synthetic yen LIBOR. Accordingly, it is unlikely for (c) to become a trigger that would activate fallback provisions as pointed out in the opinion above.

D. Special circumstances

(i) Discussions in the public consultation paper and items subject to public comments

The public consultation paper described the special circumstances in which contracts do not fall under the category of tough legacy contracts yet the transition cannot be proceeded with as follows and solicited comments.

Discussions in the public consultation paper

The Committee considers that progress has been made in the transition in line with the Roadmap in Japan. However, there is a possibility that contracts with special circumstances may arise that would make the transition difficult, especially in contracts that the Committee is not aware of. It is possible that there are existing contracts that do not fall under the above basic concept, but have special circumstances that prevent the transition, for example, where it is not appropriate to proceed with the transition with a view to protecting clients and ensuring the soundness of the Japanese financial markets and financial system.

Items subject to public comments

If there are any circumstances that do not fall under the category of tough legacy contracts as outlined by the Committee, but for which the transition cannot be proceeded with -- for example, it is not appropriate to proceed with the transition, with a view to protecting clients and ensuring the soundness of the Japanese financial markets and financial system -- please let us know the specific circumstances.

(ii) Opinions of respondents

As a result of the public consultation, many respondents expressed that there were no special circumstances where it was not appropriate to proceed with the transition. On the other hand, two of the respondents raised the following points as cases for which the transition could not be proceeded with, despite the contracts not falling under the category of tough legacy contracts outlined by the Committee.

- (a) Cases of loans, where the intention of the borrower cannot be confirmed due to the person's death or illness including dementia, and where the consent cannot be obtained from all of the person's legal heirs.
- (b) Cases of bonds, where it is impossible to proceed with the transition, as both the originator and the arranger are absent due to factors such as bankruptcy.
- (c) Cases of bonds, where the opinions of the bondholders are split regarding the transition, and where certain bondholders may be seriously disadvantaged or at risk, even if the majority comes to an agreement in the bondholders' meeting.
- (d) Cases of bonds, where the option of prepayment or cancellation are being considered as transition methods, instead of an active conversion or an insertion of fallback provisions.
- (e) Cases of products referencing the Tokyo Swap Reference Rate (LIBOR TSR) calculated and announced by Refinitiv, where the transition cannot be proceeded due to delays in the start of the publication of production rates of TONA TSR.

(iii) Views of the Committee

The Committee has summarized that contracts that fall under the basic concepts described in A and B above, are classified as tough legacy contracts in which synthetic yen LIBOR can be used.

Nonetheless, in exceptional cases such as (a) and (b), where it is difficult to proceed with the negotiations between the contracting parties and the procedures stipulated by

law, the use of synthetic yen LIBOR may be considered as a temporary measure to proceed with the transition. In such a case, consideration should be given to the content of each contract, the intentions of the contracting parties, as well as the risk mitigation measures outlined in the public consultation paper.²⁴ In addition, when synthetic yen LIBOR is used, transition to an alternative interest rate benchmark is expected to be completed as early as possible, as synthetic yen LIBOR is expected to be published only for one year and there are litigation risks when synthetic yen LIBOR is used.

With regard to case (c), it is considered possible to shift to an alternative interest rate benchmark by obtaining the consent from a majority of the bondholders through a convocation of a bondholders' meeting in accordance with the law. On the other hand, contracting parties are not prohibited from using synthetic yen LIBOR in the case of, for example, an agreement being reached.

For case (d), in addition to the transition to an alternative interest rate benchmark and the introduction of fallback provisions, contracting parties could consider other transition methods including prepayment and cancellation. The same applies to the so-called hybrid bonds.²⁵

As for case (e), the publication of production rates of TONA TSR started on October 28.

(3) Points to note on the use of synthetic yen LIBOR

The public consultation paper described the points to note when contracting parties use synthetic yen LIBOR as follows and solicited comments.

²⁴ In addition, some respondents indicated cases where the transition of cash products (loans and bonds) could not be completed and therefore the transition of derivative transactions intended for risk management could not be proceeded. Although derivative transactions are not included in the scope of this public consultation, the Committee believes that contracting parties should decide on whether or not to use synthetic yen LIBOR for such transactions based on the content of each contract and intentions of the contracting parties, taking into account "(3) Points to note on the use of synthetic yen LIBOR."

²⁵ For more information on the concept of prepayment of hybrid bonds, please refer to Q3 and Q4 of the Japanese Bankers Association's "Q&A on Bonds Referenced to LIBOR" (available only in Japanese).
https://www.zenginkyo.or.jp/fileadmin/special/libor/qa/210427_qa_bonds.pdf

A. Litigation risks

(i) Discussions in the public consultation paper and items subject to public comments

The public consultation paper described the litigation risks when synthetic yen LIBOR is used as follows and solicited comments.

Discussions in the public consultation paper

The Committee considers that, in general, the transition to synthetic yen LIBOR would not be made unconditionally, without an agreement between contracting parties, for contracts referencing LIBOR in Japan after the cessation. There are litigation risks arising to the contract if synthetic yen LIBOR is used without an agreement between the parties, because the economic value of contracts referencing panel-based JPY LIBOR and synthetic yen LIBOR may change.²⁶



Items subject to public comments

As shown above, the Committee summarized that there could be litigation risks when synthetic yen LIBOR is used. Please let us know if you have any comments on this summary.

(ii) Opinions of respondents

As a result of the public consultation, many respondents agreed with the recommendation by the Committee with regard to the litigation risks when synthetic yen LIBOR is used.

In particular, one of the respondents commented that it was difficult to regard panel-based JPY LIBOR and synthetic yen LIBOR as benchmarks maintaining a similar substantive identity, and that switching the interest rate benchmarks would require an amendment of terms and conditions of a contract which the contracting parties need

²⁶ In Japan, it is assumed that there are no safe harbor provisions (exemption clauses) aimed at minimizing material risks and uncertainties in the interpretation and management of contracts that reference synthetic LIBOR.

to agree upon. Another respondent pointed out the necessity of summarizing the points on litigation risks, due to the lack of exemption clauses in Japan to mitigate the risks and uncertainties when using synthetic yen LIBOR.

On the other hand, two of the respondents expressed their concerns about the possibility of synthetic yen LIBOR to be referenced even in the absence of an agreement between the contracting parties, taking into account the details of the publication of synthetic yen LIBOR.

(iii) Views of the Committee

There may be cases where it might be interpreted to use synthetic yen LIBOR even in the absence of an agreement between the contracting parties, depending on the content of each contract and intentions of the parties. Nevertheless, as mentioned in the comments above, there were views that it would be difficult to regard panel-based JPY LIBOR and synthetic yen LIBOR as benchmarks maintaining a similar substantive identity. Therefore, contracting parties are expected to take this view into consideration when deciding on whether or not to use synthetic yen LIBOR.

B. Sharing understanding between contracting parties and different measures according to the content of contracts

(i) Discussions in the public consultation paper and items subject to public comments

The public consultation paper described sharing of understanding between contracting parties and different measures reflecting the content of contracts that were considered necessary to avoid litigation risks when using synthetic yen LIBOR as follows and solicited comments.

Discussions in the public consultation paper

(Sharing understanding between contracting parties)

To avoid litigation risks, it is necessary for the contracting parties to agree on the use of synthetic yen LIBOR, or to agree through procedures to change contracts as stipulated by law in the case of bonds. However, under the circumstances where no agreement has been reached based on the negotiations and modification procedures as described in (2) A. above, it may be difficult to agree on the use of synthetic yen LIBOR. In this case, in order to mitigate litigation risks regarding the use of synthetic yen LIBOR, measures to share understanding among contracting parties may be considered, even if they do not reach an agreement.^{27,28}

The following are some of the details of the understanding that should be shared.²⁹

- ✓ Adopting a synthetic yen LIBOR instead of the current yen LIBOR (panel-based JPY LIBOR)
- ✓ Adopting a synthetic yen LIBOR on the date of the first revision of interest rates after the cessation of the panel-based JPY LIBOR
- ✓ The fact that it will not be feasible for synthetic yen LIBOR to replicate precisely the economic value of contracts referencing panel-based JPY LIBOR, as synthetic yen LIBOR will be produced using a different methodology not reliant on panel bank submissions

²⁷ The joint statement released by the FSA and the BOJ, "Response to the announcement on the end date of LIBOR panel publication and the announcement on the intention to consult on the publication of synthetic yen LIBOR," also states that "it is necessary for all parties concerned to share an understanding of the fact that economic values can change." For details, please refer to the following links.

(FSA) <https://www.fsa.go.jp/en/policy/libor/syntheticlibor202102.pdf>

(BOJ) https://www.boj.or.jp/en/announcements/release_2021/data/rel210308a.pdf

²⁸ When sharing understanding in loan contracts, financial institutions should be aware of "abuse of dominant bargaining position" and other issues. In the case of bonds, if an issuer entrusts an agent with operations including interest payments and the confirmation of interest rates, and the agent uses synthetic yen LIBOR, the policy for using synthetic yen LIBOR should be shared with the entrusted agent in advance, and the agent should use synthetic yen LIBOR based on a request from the issuer afterwards.

²⁹ Since the content that needs to be shared may vary depending on, for example, the content of the contract, the public consultation paper provided a typical example. In practice, details of the recognition to be shared should be considered according to the content of each contract and intentions of the contracting parties. It would also be desirable 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 fallback provisions, the contents shared among the contracting parties, and additional efforts made to reduce risks.

- ✓ 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)

As for the means of sharing understanding, parties involved in loan contracts can negotiate on the points above and the lender, for example, can keep record of the negotiation in the form of a memorandum.

In the case of certain types of bonds including publicly offered bonds, where there are an unspecified number of bondholders, it is assumed that it may be difficult to negotiate between the contracting parties. In this case, measures including the following can be considered as means of sharing understanding: (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.

(Different measures according to the content of contracts)

Litigation risks will remain, even if the above-mentioned measures to share understanding are taken, as long as an agreement is not reached between the contracting parties. Moreover, the specific details and extent of risks will vary depending on the content of each contract and intentions of the contracting parties.

Therefore, it is desirable for contracting parties who are considering the use of synthetic yen LIBOR to take effective measures to mitigate litigation risks by, for example, consulting with lawyers as necessary.

In addition to litigation risks, there is a possibility that the use of synthetic yen LIBOR will require addressing hedge accounting and tax-related issues. The Committee expects that these points will be deliberated by the relevant parties and that necessary measures will be taken by individual contracting parties.

Nonetheless, taking into account the deliberations by the Committee thus far, it is considered desirable to shift from synthetic yen LIBOR to an alternative interest rate benchmark as early as possible, on the assumption that synthetic yen LIBOR is expected to be published only for one year.

Items subject to public comments

As shown above, as a measure to mitigate litigation risks, the Committee summarized the significance of sharing understanding between contracting parties, the content and measures for sharing, and the necessity of other measures according to the content of the contract. Please tell us if there are any excesses or deficiencies in this summary, and if so, what the specifics are.

(ii) Opinions of respondents

As a result of the public consultation, many respondents commented that the summary in the public consultation paper did not have any excesses or deficiencies.

One of the respondents who supported this summary commented that the Committee's view on sharing understanding in the absence of a clear agreement was appropriate and reasonable, as the contracting parties would be able to mitigate the litigation risks by continuing discussions, even if one of the parties later made a claim or payment based on synthetic yen LIBOR.

On the other hand, one of the respondents questioned (a) whether litigation risks could be avoided regardless of the content of the contract, in response to the summary of risks. Another respondent pointed out that (b) synthetic yen LIBOR should be available for more than one year, since there might be tough legacy contracts maturing after the turn of January 2023.

(iii) Views of the Committee

With respect to (a) above, there may be cases where it might be interpreted to use synthetic yen LIBOR even in the absence of an agreement between the contracting parties, depending on the content of each contract and intentions of the parties.

However, contracting parties should note that it would be difficult to regard panel-based JPY LIBOR and synthetic yen LIBOR as benchmarks maintaining a similar substantive identity, as stated in the supporting comments of (3) A.

As for (b), the publication period of synthetic yen LIBOR will be limited to one year, according to the FCA's announcement.

C. Other risks and countermeasures

(i) Discussions in the public consultation paper and items subject to public comments

The public consultation paper described other risks and countermeasures as follows and solicited comments.

Discussions in the public consultation paper

The Sub-Group on Loans and the Sub-Group on Bonds proposed to broadly listen to the opinions of the parties on the content of litigation risks, the significance of sharing understanding and whether there is anything missing in the content and measures.

At the same time, the Committee would like to hear opinions from a broad range of respondents on whether there are other potential risks when using synthetic yen LIBOR, in addition to what is described in this public consultation paper, and if so, what kind of countermeasures there may be when addressing such risks.

Items subject to public comments

Please tell us whether there are any measures other than the measures to mitigate litigation risks organized by the Committee, and whether there are any risks not organized in this consultation, and if so, what the specifics of each are.

(ii) Opinions of respondents

As a result of the public consultation, many respondents commented that there was no excess or deficiency in the views of the Committee on the content of the litigation risks and the significance of sharing understanding.

On the other hand, two of the respondents provided comments on additional risks and the measures to mitigate them. Specifically, (a) if fallback provisions included permanent cessation triggers but not pre-cessation triggers concerning the loss of representativeness, the fallbacks may not be triggered and synthetic yen LIBOR may be referenced. Furthermore, (b) since synthetic yen LIBOR will be calculated using TORF, it is desirable to publish the operational rules and code of conduct regarding TORF as soon as possible, in order for the contracting parties to be able to recognize the difference in economic value between synthetic yen LIBOR and panel-based JPY LIBOR.

(iii) Views of the Committee

Regarding the conditions on which fallback provisions (triggers) are activated, referred to in (a), it was recommended by the Committee in the first and second public consultations, to introduce both permanent cessation triggers and pre-cessation triggers, and this recommendation has gained support from market participants. However, there still remain some contracts that have not introduced fallback provisions with pre-cessation triggers concerning the loss of representativeness. For these contracts, the fallback provisions might not be triggered. In this case, there are risks that there will consequently be no interest rate benchmarks for the contracting parties to refer to, or that synthetic yen LIBOR will be referred unintentionally. To avoid such risks, contracting parties are expected to introduce pre-cessation triggers as early as possible.

With regard to (b), the Committee has been supporting the efforts of market participants to build TORF governance and to enhance and improve transparency of its calculation method. Moreover, QUICK Benchmarks, Inc., the calculating and publishing entity of TORF, received approval for its operational rules related to TORF

calculation under the Financial Instruments and Exchange Act and published the relevant rules (including TORF Operational Rules and TORF Code of Conduct) on October 26, 2021.³⁰

(4) The way of thinking in transition away from JPY LIBOR in Japan

(i) Discussions in the public consultation paper and items subject to public comments

The public consultation paper described the way of thinking in transition away from JPY LIBOR in Japan as follows and solicited comments.

Discussions in the public consultation paper

It is considered important that market participants continue to proceed with preparations for transition in line with the Roadmap, given that progress has been already made in line with the Roadmap in Japan and that there are points to note when using synthetic yen LIBOR.

Items subject to public comments

Please describe whether you agree or disagree with the aforementioned discussion and explain why.

(ii) Opinions of respondents

As a result of the public consultation, a large majority of the respondents agreed with the Committee’s view (Figure 2-5).

Figure 2-5: Opinions of respondents on the way of thinking in transition away from JPY LIBOR in Japan

Agree	Disagree
33 respondents	1 respondent (1 securities company)

³⁰ <https://www.torf.co.jp/en/2021/10/26/pressrelease1026/>

Those who have agreed expressed views that it was important to proceed in line with the Roadmap in Japan, a wide range of market participants using LIBOR should refer to the Roadmap in Japan on the use of LIBOR and complete the transition as early as possible, and that these efforts would help set a de facto standard in the markets. Moreover, some respondents also pointed out that it was important to complete the transition away from JPY LIBOR in the markets as a whole, the Roadmap was useful as it encouraged and supported those involved in the process, and that excessive dependence on synthetic yen LIBOR may hinder the soundness of the markets.

On the other hand, those who have disagreed expressed views that the Committee should extend the Roadmap to include milestones after the turn of 2022, and that it should clearly state that the transition would continue after the end of 2021. In addition, the respondent also pointed out that market participants should continue to make efforts to voluntarily complete their transition from JPY LIBOR after the turn of 2022.

(iii) Views of the Committee

The Committee has formulated the Roadmap in Japan, which includes the milestones that market participants should refer to when developing their transition, based on the overseas trends and requests from market participants. The Committee has also supported the transition in Japan before the end of 2021, when the cessation of panel-based JPY LIBOR would take place.

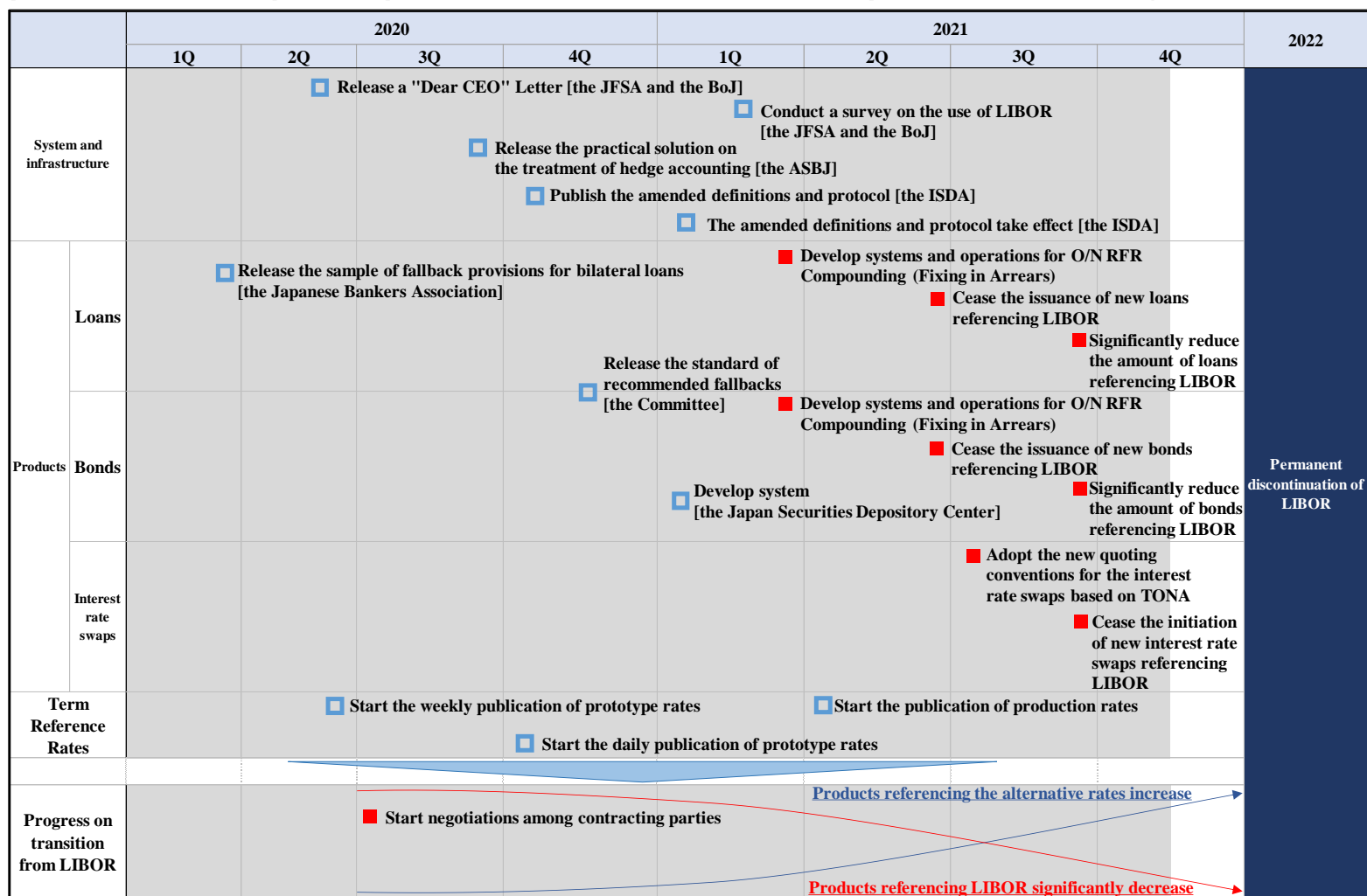
The Committee continues to recommend that the transition be completed by the end of 2021. On the other hand, if it is not possible to do so by the end of 2021, market participants are expected to continue their discussions after the turn of 2022 and complete the transition by the day of the first revision of interest rates at the latest. In addition, when using synthetic yen LIBOR, it is desirable for the market participants to shift synthetic yen LIBOR to an alternative interest rate benchmark as early as possible, bearing in mind that the publication of synthetic yen LIBOR is scheduled to be limited to one year and that there might be litigation risks involved.

3. Conclusion

Most of the responses to the items subject to public comments in the public consultation paper were in support of the Committee's views and the respondents' comments were mainly complementary. Moreover, the Committee received support from a wide range of relevant parties, including financial institutions and business corporations. As shown in Appendix 2, the Committee is revisiting its views regarding (a) the concept of contracts that could consider using synthetic yen LIBOR as tough legacy contracts and (b) the points to note when using synthetic yen LIBOR between contracting parties described in the public consultation paper, taking into account the comments received from the respondents.

The Committee expects that this report will be regarded as a standard in Japanese markets for tough legacy contracts, and that a wide range of market participants in Japan will proceed with their preparations for the transition in line with this report.

Appendix 1: Roadmap to Prepare for the Discontinuation of Japanese Yen LIBOR (as of November 2021)



Notes:1. ■ indicates measures to be taken by each firm.

2. In this roadmap, "LIBOR" refers to the conventional one based on a methodology in which the rate is calculated using the rates submitted by the panel banks.

3. "Cease the initiation of new interest rate swaps referencing LIBOR" shall be applied to transactions except those intended for risk management of existing positions. In addition, the sub-group shall not preclude financial institutions from executing those transactions which would result in increasing LIBOR exposure for their customers and not require financial institutions to confirm their customers' purposes of trade before and after selling financial instruments or executing transactions (please refer to "Report from the Sub-Group for the Development of Term Reference Rates," material for the Mar. 26, 2021 meeting.)

Appendix 2: the Treatment of Tough Legacy Contracts in Japan^{31,32}

1. The concept of contracts that could consider using synthetic yen LIBOR as tough legacy contracts

The Committee considers that contracts that fall under the basic concept described below could consider using synthetic yen LIBOR as tough legacy contracts.

However, this does not exclude the use of synthetic yen LIBOR by an agreement between the contracting parties, for contracts that do not fall under the basic concept described below. The decision on whether or not to use synthetic yen LIBOR should be made by the contracting parties, based on the content of each contract and intentions of the contracting parties, taking into account the considerations outlined in the public consultation paper.

(1) Basic concept

A. Loans

Loan contracts are considered negotiable in terms of making changes because it is easy to specify the contracting parties. That being said, it would be important that contracting parties take into account the limited time left before the cessation of panel-based JPY LIBOR and conduct negotiations in good faith when they make changes to their contracts.

On the other hand, it is also possible that there are contracts that cannot be agreed upon even after such negotiations. For this reason, it has been deemed appropriate to consider contracts that fulfill the following conditions as tough legacy contracts.

³¹ This Appendix revisits the views of the Committee regarding (a) the concept of contracts that could consider using synthetic yen LIBOR as tough legacy contracts, and (b) the points to note when using synthetic yen LIBOR between contracting parties, as stated in the public consultation paper, taking into account the comments received in the consultation. The definition of the terms used in this Appendix is the same as those used in the main document.

³² The subject of consideration of the public consultation paper and this report is existing contracts for loans and bonds that reference JPY LIBOR under the governing Japanese law. In addition, for transactions referencing USD LIBOR, GBP LIBOR, CHF LIBOR, and EUR LIBOR, responses must be made based on the timelines and guidance provided by the home authorities of each currency. It is expected that products that reference JPY LIBOR and are based on laws in other countries and regions will be subject to review in each jurisdiction.

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 provisions³³ 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.³⁴

However, in the above discussion, the contracting parties should pay particular attention to the following points with a view to promoting smooth discussions.³⁵

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

B. Bonds

In many cases, bond contracts have procedures for amending the contracts specified by law.³⁶ That being said, it would be important for issuers to take into account the limited time left before the cessation of panel-based JPY LIBOR and to work on the transition either through a convocation of bondholders' meetings or by obtaining the consent from all of the bondholders.

³³ In the Committee's first and second public consultations, the hardwired approach, which falls back to the replacement rate determined upon the introduction of fallback provisions, had gained support from market participants. In addition, regarding the conditions on which fallback provisions (triggers) are activated, it was recommended by the Committee to introduce both permanent cessation triggers and pre-cessation triggers, and this recommendation has gained support from market participants.

³⁴ 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.

³⁵ 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.

³⁶ Structured bonds and securitized instruments are included in the bonds that have procedures to modify contracts specified by law; however, this report uses the terms "corporate bonds" and "bondholders" unless otherwise specified, taking account of corporate bonds under the Companies Act. With regard to bonds that do not fall under the category of corporate bonds under the Companies Act, the terms "corporate bonds" and "bondholders" in the text should be read as terms equivalent to "corporate bonds" and "bondholders" in the relevant laws and regulations.

On the other hand, despite these efforts, there may be contracts for which the transition cannot be completed before the end of 2021. For this reason, it has been deemed appropriate to consider the contracts that fulfill the following conditions as tough legacy contracts.

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 provisions³⁷) 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.³⁸

However, the contracting parties should pay particular attention to the following points, with a view to facilitating the above procedures.³⁹

Issuers : to try to provide explanation to the bondholders in good faith and in a careful manner

Bondholders: to respond to the explanations provided by the issuers in good faith

³⁷ Please refer to footnote 33.

³⁸ 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.

³⁹ 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.

C. Points in common to loans and bonds

In discussions and modification procedures between contracting parties, the following information should be explained to the borrower by the lender or to the bondholder by the issuer, for example, so that there is no misunderstanding about the purpose and content of the discussions and modifications.^{40,41}

- ✓ 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 consultation papers held by the Committee with regard to the options of alternative interest rate benchmarks in the active conversion and fallback provisions
- ✓ 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

When discussing the above in the context of loans, financial institutions should explain that future transactions will not be affected by whether there is an agreement or not on the introduction of an active conversion/fallback provisions and should pay careful attention to, for example, the fact that this may be considered abuse of dominant bargaining position under the Banking Act.

Although the Committee recommended that the transition be completed before the cessation of panel-based JPY LIBOR which is the end of 2021, if the transition cannot be completed by then, it would be desirable for market participants to continue with discussions until the day of the first revision of interest rates after the turn of 2022 and complete the transition as early as possible.

⁴⁰ 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. Moreover, if bondholders' meetings are to be held, matters including the content indicated herein should be included in the reference documents for the meeting of bondholders and voting documents to be delivered to bondholders in accordance with the Companies Act, with a view to providing information to all bondholders in advance.

⁴¹ It is desirable for entities including financial institutions and issuers to consult with, for example, lawyers, as necessary, and to be able to explain the reasonableness of the extent of such explanation after the fact.

(2) Considering the use of synthetic yen LIBOR

For contracts that fall under "(1) Basic concept" above, the use of synthetic yen LIBOR may be considered as a "safety net" as there will be no interest rate benchmarks to rely on due to the cessation of panel-based JPY LIBOR.

In such cases, there are no laws and regulations in Japan that regulate the use of specific interest rate benchmarks, and individual contracting parties need to decide on whether or not to use synthetic yen LIBOR for tough legacy contracts, based on the content of the contracts and intentions of the parties concerned, taking into account the points to be noted.⁴²

(3) Special circumstances

For existing contracts that do not fall under the above "(1) Basic concept," the use of the synthetic yen LIBOR may be considered as a temporary measure to proceed with the transition to an alternative interest rate if there are special circumstances that prevent the transition, for example, where it is not appropriate to proceed with the transition with a view to protecting clients and ensuring the soundness of the Japanese financial markets and financial system. In such a case, consideration should be given to the content of each contract and intentions of the contracting parties, including the risk mitigation measures outlined in the public consultation paper.⁴³

⁴² The FSA and the BOJ have indicated that they will check the status of the use of synthetic yen LIBOR and customer support as necessary. For more information, please refer to the following links.

(FSA) <https://www.fsa.go.jp/en/policy/libor/syntheticlibor202102.pdf>

<https://www.fsa.go.jp/news/r3/20210831/20210831.html> (available only in Japanese)

(BOJ) https://www.boj.or.jp/en/announcements/release_2021/data/rel210308a.pdf

⁴³ In addition, some respondents indicated cases where the transition of cash products (loans and bonds) could not be completed and therefore the transition of derivative transactions intended for risk management could not be proceeded. Although derivative transactions are not included in the scope of this public consultation, the Committee believes that contracting parties should decide on whether or not to use synthetic yen LIBOR for such transactions based on the content of each contract and intentions of the contracting parties, taking into account "2. Points to note on the use of synthetic yen LIBOR."

2. Points to note on the use of synthetic yen LIBOR

(1) Litigation risks

It is considered that, in general, the transition to synthetic yen LIBOR would not be made unconditionally, without an agreement between contracting parties, for contracts referencing LIBOR in Japan after the cessation. On the other hand, there may be cases where it might be interpreted to use synthetic yen LIBOR even in the absence of an agreement between the contracting parties, depending on the content of each contract and the intentions of the parties. In any case, there are litigation risks arising to the contract if synthetic yen LIBOR is used without an agreement between the parties, because the economic value of contracts referencing panel-based JPY LIBOR and synthetic yen LIBOR may change.⁴⁴

(2) Sharing understanding between contracting parties

Litigation risks could be prevented in most of the existing contracts referencing JPY LIBOR in Japan, if there is an agreement between the contracting parties or consent by the procedures stipulated by laws. However, contracting parties are unlikely to come to an agreement when using synthetic yen LIBOR, as the parties are unable to agree on the transition to an alternative interest rate benchmark in the first place. Accordingly, other methods may be taken to mitigate litigation risks in cases when a clear agreement cannot be reached, such as contracting parties continuing with their discussions.^{45,46}

⁴⁴ In Japan, it is assumed that there are no safe harbor provisions (exemption clauses) aimed at minimizing material risks and uncertainties in the interpretation and management of contracts that reference synthetic LIBOR.

⁴⁵ The joint statement "Response to the announcement on the end date of LIBOR panel publication and the announcement on the intention to consult on the publication of synthetic yen LIBOR" by the FSA and the BOJ also states that "it is necessary for all parties concerned to share an understanding of the fact that economic values can change." For more information, please refer to the following links.

(FSA) <https://www.fsa.go.jp/en/policy/libor/syntheticlibor202102.pdf>

(BOJ) https://www.boj.or.jp/en/announcements/release_2021/data/rel210308a.pdf

⁴⁶ When sharing understanding in loan contracts, financial institutions should be aware of "abuse of dominant bargaining position" and other issues. In the case of bonds, if an issuer entrusts an agent with operations including interest payments and the confirmation of interest rates, and the agent uses synthetic yen LIBOR, the policy for using synthetic yen LIBOR should be shared with the entrusted agent in advance, and the agent should use synthetic yen LIBOR based on a request from the issuer afterwards.

The following are some of the details of the understanding that should be shared.⁴⁷

- ✓ Adopting a synthetic yen LIBOR instead of the current yen LIBOR (panel-based JPY LIBOR)
- ✓ Adopting a synthetic yen LIBOR on the date of the first revision of interest rates after the cessation of the panel-based JPY LIBOR
- ✓ The fact that it will not be feasible for synthetic yen LIBOR to replicate precisely the economic value of contracts referencing panel-based JPY 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 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)

As for the means of sharing understanding, parties involved in loan contracts can negotiate on the points above and the lender, for example, can keep record of the negotiation in the form of a memorandum.

In the case of certain types of bonds including publicly offered bonds, where there are an unspecified number of bondholders, it is assumed that it may be difficult to negotiate between the contracting parties. In this case, measures including the following can be considered as means of sharing understanding: (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.

⁴⁷ Since the content that needs to be shared may vary depending on, for example, the content of the contract, this public consultation provides a typical example. In practice, details of the recognition to be shared should be considered according to the content of each contract and intentions of the contracting parties. It would also be desirable 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 fallback provisions, the contents shared among the contracting parties, and additional efforts made to reduce risks.

(3) Different measures according to the content of contracts

Litigation risks will remain, even if the above-mentioned measures to share understanding are taken, as long as an agreement is not reached between the contracting parties. Moreover, the specific details and extent of risks will vary depending on the content of each contract and intentions of the contracting parties.

Therefore, it is desirable for contracting parties who are considering the use of synthetic yen LIBOR to take effective measures to mitigate litigation risks by, for example, consulting with lawyers as necessary.

Nonetheless, taking into account the deliberations by the Committee thus far, it is considered desirable to shift from synthetic yen LIBOR to an alternative interest rate benchmark as early as possible, on the assumption that synthetic yen LIBOR is expected to be published only for one year.

(4) Other risks and countermeasures

Regarding the conditions on which fallback provisions (triggers) are activated, it was recommended by the Committee in the first and second public consultations, to introduce both permanent cessation triggers and pre-cessation triggers, and this recommendation has gained support from market participants. However, there still remain some contracts that have not introduced fallback provisions with pre-cessation triggers concerning the loss of representativeness. For these contracts, the fallback provisions might not be triggered. In this case, there are risks that there will consequently be no interest rate benchmarks for the contracting parties to refer to, or that synthetic yen LIBOR will be referred unintentionally. To avoid such risks, contracting parties are expected to introduce pre-cessation triggers as early as possible.

In addition, there is a possibility that the use of synthetic yen LIBOR will require addressing hedge accounting and tax-related issues. The Committee expects that these points will be deliberated by the relevant parties and that necessary measures will be taken by individual contracting parties.