Developments in Japanese yen LIBOR transition: the Japanese perspective

by **Keiko Nakada**

Among the global initiatives, there have been accelerating efforts by Japanese financial market stakeholders to prepare for the permanent cessation of Japanese yen LIBOR publication at the end of 2021. This article highlights some of the latest initiatives in the development of the Japanese yen LIBOR alternative risk-free rate, and in Japanese yen LIBOR transition.

In August 2018, the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (the Committee) was established to deliberate and make recommendations to prepare for permanent cessation of LIBOR publication. Membership of the Committee includes diverse financial market players, joined by the Bank of Japan (BOJ, the secretariat) and the Financial Services Agency (JFSA) and other financial market stakeholders (such as industry associations) as observers.

According to the Committee's Roadmap updated in April 2021, which indicates milestones that market participants should reflect in their own transition plan, the issuance of new bonds referencing Japanese yen LIBOR are to be ceased by the end of June 2021 and the amount of outstanding legacy contracts for bonds referencing Japanese yen LIBOR are to be reduced substantially by the end of September 2021.

RFR, alternative rates and fallback provisions

In December 2016, the uncollateralised overnight call rate, based on actual overnight transactions, was identified as the Japanese yen risk-free rate. The daily average (Tokyo Overnight Average Rate: TONA) is calculated and published by the Bank of Japan.

In July 2019, the Committee released a Public Consultation on the *Appropriate Choice and Usage of Japanese Yen Interest Rate Benchmarks* (the First Consultation). In November 2019, the Committee published the *Final Report on the Results of the Public Consultation on the Appropriate Choice and Usage of Japanese Yen Interest Rate Benchmarks*, proposing the five potential alternative interest rate indicator options[1]. The First Consultation also indicated the application of both permanent cessation triggers and pre-cessation triggers.

The alternative rates and fallback provisions for bonds were also discussed by a group of securities market participants, the Discussion Group on Interest Rate Benchmark Transition, hosted by the Japan Securities Dealers Association. The group submitted comments[2] to the Bond Sub-Group of the Committee.

Based on the results of the First Consultation and following deliberations, the Committee published the *Second Public Consultation on the Appropriate Choice and Usage of Japanese Yen Interest Rate Benchmarks* (the Second Consultation) in August 2020, which recommended adopting fallback rates in the waterfall structure under a hardwired approach for bonds. The proposed priority of the rates is as follows:

1st priority	Term Reference Rates
2nd priority	O/N RFR Compounding (fixing in arrears)
3rd priority	Rates recommended by the authority-related committee (committees recommended or convened by the central bank or the relevant authority)
4th priority	ISDA Fallback Rate
5th priority	Rates selected by issuers

1. Five options were: (1) O/N RFR Compound (Pre-determined), (2) O/N RFR Compound (fixing in Arrears), (3) Term RFR Interest rate (swap), (4) Term RFR Interest rate (Future), and (5) TIBOR.

Options (3) and (4) were merged as Term Reference Rate after the 1st Consultation.

2. https://www.jsda.or.jp/shijyo/minasama/libor/fallback.pdf (Japanese only)

The Second Consultation also recommended that the historical median approach over a five-year lookback period be applied as a credit adjustment spread. The results of the second public consultation showed that almost all respondents supported each of these recommendations.

Term Reference Rates: The first priority of the waterfall structure is the Term Reference Rate. In April 2021, QUICK Benchmarks Inc. began publishing production rates for the Tokyo Term Risk Free Rate (TORF), a forward-looking term interest rate based on the overnight index swaps (OIS) rate.

O/N RFR Compounding (fixing in arrears): The second priority is the Overnight RFR compounding (fixing in arrears), which uses TONA, and which was explored in detail by the Sub-Group on Loans and subsequently reported to the Committee. In accordance with the updated Roadmap, firms have been expected to develop systems and operations for calculating overnight RFR compounding (fixing in arrears) by the first quarter of 2021.

In addition, QUICK Corp. started publishing the TONA compounded index and TONA averages derived from daily compounded TONA for 30 days, 90 days, and 180 days.

Current status of Japanese yen LIBOR-linked bonds

Looking at the bond market, the Japan Securities Depository Center Inc. (JASDEC), the central depository of corporate bonds issued in Japan, reported[3] their survey results on Japanese yen LIBOR linked bonds to the Committee, indicating that the number of total outstanding issues was 229 as of the end of March 2021. The breakdown is: 45 corporate bonds (public 10, private 35), 180 hybrid bonds (public 116, private 64), and 4 others. Among hybrid bonds, which typically are callable fixed-to-float rate bonds, a large part is issued by financial institutions. None of the hybrid bonds or “others” refer to LIBOR at the date of the survey (31 March 2021).

Changing existing bond contracts

The process of changing the contents of contracts of existing corporate bonds issued under Japanese law to either make a transition to an alternative benchmark or introduce a fallback provision, are indicated by the revised Companies Act (2021). The following two options should be considered when amending bond contracts to transition from LIBOR.

(i) Hold bond creditors’ meetings, file a resolution with the court for approval, and make a public notice after court approval without delay.

(ii) With the consent of all bond creditors, it is deemed that there has been a resolution of the bond creditors’ meeting, and the procedure set out in (i) is omitted.

On the Committee held on 27 April 2021, the JFSA urged corporate bond issuers to take initiatives in making the transition or introducing the fallback provision while consulting with relevant stakeholders. JFSA expects corporate bond issuers to develop their transitioning policies as soon as possible and work closely with JASDEC if they decide to hold a bondholders’ meeting.

Continued efforts

To facilitate responses in preparation for the permanent cessation of LIBOR publication and to confirm the status of responses, in June 2020, FSA and BOJ jointly sent Notices to representatives of financial institutions (“Dear CEO Letters”), setting out a list of required actions to be taken by financial institutions, and a request for submission for relevant materials to ensure, *inter alia*, an understanding and evaluation of the risks arising from the cessation of LIBOR, and an assessment of appropriate actions taken to mitigate and manage the identified risks.

Masayoshi Amamiya, Deputy Governor of the Bank of Japan, addressed the situation in his recent speech, saying that: “Most of the necessary tools to achieve a smooth LIBOR transition have been already provided. ... (T)he success of the LIBOR transition essentially depends on whether each individual market participant will make a good use of those tools and take necessary actions in a steady and swift manner. ... We are already in the phase to be fully determined to make steady progress in the transition activities for the completion of the LIBOR transition.”

Keiko Nakada, Japan Securities Dealers Association, is currently on secondment to ICMA.

3. Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks Meeting Material for 27 April 2021 (Twenty-second Meeting) Report submitted from JASDEC https://www.boj.or.jp/paym/market/jpy_cmte/index.htm/ (Japanese only)