

(Provisional Translation)

March 8, 2021

Dear the representatives of each association,

NAKAJIMA Junichi, Director-General
Strategy Development and Management Bureau
Financial Services Agency

KURITA Teruhisa, Director-General
Supervision Bureau
Financial Services Agency

MASAKI Kazuhiro, Director-General
Financial System and Bank Examination Department
Bank of Japan

OTANI Akira, Director-General
Financial Markets Department
Bank of Japan

(Official seals are omitted)

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

On March 5, 2021, ICE Benchmark Administration (IBA) has announced that it intends to cease the publication of London Interbank Offered Rate (LIBOR) based on the current methodology referencing rates provided by panel banks (panel-based LIBOR) immediately after end-2021 except for certain US dollar LIBOR settings.

In addition, the UK Financial Conduct Authority (FCA) has announced on the same day that it will consult on the use of the proposed powers under the UK Financial Services Bill to require IBA to publish the 1-month, 3-month and 6-month Japanese yen (JPY) LIBOR settings on a synthetic basis (synthetic LIBOR) for one additional year after end-2021.

In consideration of the above announcements, the attached statement is the expectation of the Financial Services Agency (FSA) and Bank of Japan (BOJ) on transition away from panel-based LIBOR and on synthetic yen LIBOR, and it is requested to provide this to your member financial institutions.

1. Actions needed toward the end of 2021 when panel-based JPY LIBOR will cease

In principle, either active conversion to alternative reference rates or insertion of fallback language is necessary for legacy contracts referencing LIBOR in preparation for the permanent cessation of LIBOR.

IBA has clarified that panel-based LIBOR will cease at the end of 2021, except for certain US dollar LIBOR settings. Accordingly, it is important that each financial institution proceeds to explain to its customers and amends contracts to progress either active conversion or insertion of fallback language as soon as practicable, in conformity with the “Roadmap to prepare for the discontinuation of LIBOR” released by the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks in August 2020 as well as the transition plan of each financial institution.

While the FCA has announced that it will consult on using the proposed new powers to require publication of synthetic yen LIBOR for one additional year after end-2021, the Financial Services Bill introduced to the UK Parliament in October 2020 has not yet been enacted. Even if the Bill is enacted, in the UK, as expected, the FCA could only compel IBA to publish a synthetic LIBOR for a limited period of time, and its use will be restricted to legacy contracts that cannot feasibly be transitioned away from LIBOR (i.e. so called ‘tough legacy’).

Therefore, it is of utmost importance that preparations toward the transition away from LIBOR continue without reliance on synthetic LIBOR. Continuous efforts are necessary in alignment with the timeline indicated in the Roadmap,¹ that is to cease the issuance of new loans and bonds referencing JPY LIBOR by the end of June 2021, and to significantly reduce the amount of loans and bonds referencing JPY LIBOR by the end of September 2021.

2. Use of synthetic yen LIBOR

The FCA will decide whether to require publication of synthetic yen LIBOR, after taking into account of the result of future consultation on this issue, subject to the proposed powers in the Financial Services Bill being enacted by UK Parliament. While it is premature to consider the use of synthetic yen LIBOR at the moment, the following is the current expectation of the FSA and BOJ on potential publication of synthetic yen LIBOR.

¹ With regard to contracts or transactions referencing LIBOR for currencies other than JPY, actions are required in accordance with timeline or guidance published by relevant national working groups or supervisory authorities.

(1) Use of synthetic yen LIBOR in new contracts and transactions

As described above, the use of synthetic LIBOR will be restricted to tough legacy, and synthetic yen LIBOR will be available only for one year.

It is of utmost importance to steadily reduce the amount of contracts referencing JPY LIBOR to advance orderly transition away from JPY LIBOR, even if synthetic yen LIBOR can be a "safety net." Any synthetic yen LIBOR should not be used in new contracts and transactions.

(2) Use of synthetic yen LIBOR in legacy contracts and transactions

In the UK, there will be a general prohibition on the use of a synthetic LIBOR by UK supervised entities. The FCA may permit certain legacy use of a synthetic LIBOR and will consult on it later in 2021 separately from the consultation on the use of the proposed powers to require publication of synthetic yen LIBOR. Also, the UK Working Group on Sterling Risk-Free Reference Rates published a *Paper on the identification of Tough Legacy issues* in May 2020, and described 'tough legacy' as contracts that prove unable to convert or be amended to include robust fallbacks ahead of LIBOR discontinuation. The paper sets out the Working Group's view on considerations which may mean that a contract falls into the category of 'tough legacy', which includes if a contract has a linkage to another tough legacy contract, such as through a hedging relationship.

Meanwhile, the Cross-Industry Committee wrote that "market participants should actively transition legacy contracts and instruments through either an active conversion or an insertion of robust fallback languages" in its comment letter to the FCA, responding to the consultation on proposed policy with respect to the exercise of the FCA's powers under new Article 23D, and published it in February 2021. It also presented a view that, while it is yet to confirm those contracts and instruments that cannot practicably be transitioned away from JPY LIBOR at this moment, there are potential risks and uncertainties where inevitable delay in the achievement of milestones may occur in certain legacy contracts, even though the preparation toward the transition is picking up going forward. It considers that synthetic yen LIBOR would help deal with these risks and uncertainties².

Considering the above, in Japan, synthetic yen LIBOR should be considered as a potential "safety net" and used only for legacy contracts that cannot feasibly be transitioned away from JPY LIBOR after proceeding thoroughly with actions mentioned above (section 1) . It should also be noted that the FCA's proposal is to limit the publication period of synthetic yen LIBOR to one year.

In addition, it is necessary that relevant parties share a common understanding of the fact that it will not be feasible for synthetic LIBOR to replicate precisely the value of a panel-based LIBOR as a synthetic LIBOR will be produced using a different methodology not reliant on panel bank submissions.

² Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks, Response to "Consultation on proposed policy with respect to the exercise of the FCA's powers under new Article 23D," February 3, 2021

Furthermore, the Cross-Industry Committee, in close cooperation with a wide range of market participants, intends to discuss the risks and uncertainties with a view to considering the nature of potential tough legacy that cannot be transitioned away from JPY LIBOR before the end of 2021³. It is expected that the discussion at the Committee will be held given the views expressed above.

3. FSA and BOJ's response

The FSA and BOJ will continue to monitor the financial institutions' progress of transition away from LIBOR and their engagement with their customers. If synthetic yen LIBOR is published, the use of synthetic yen LIBOR at the financial institutions and their engagement with their customers will be also monitored if necessary.

The FSA will consider taking supervisory measures as deemed appropriate.

³ See above.