

The Experience of Interest Rate Benchmark Reform in Japan
A Reflection Focusing on the Transition of Related Meeting Bodies

December 2023
Cross-Industry Forum on Interest Rate Benchmarks

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1. Introduction

The LIBOR transition constituted the core task of the interest rate benchmark reform that had been carried out globally for more than a decade. Following the discontinuation of Japanese Yen (JPY) LIBOR at the end of 2021, the cessation of US dollar (USD) LIBOR -- the biggest remained milestone -- passed at end-June of 2023 without major disruptions. In light of these developments, the Cross-Industry Forum on Interest Rate Benchmarks (hereinafter "the Forum") was judged to have achieved its primary objectives and brought its activity to an end at its sixth meeting held on December 5, 2023.

As the use of LIBOR was so pervasive, particularly at the early stage of the transition, there were concerns that the entire financial market and, ultimately, economic activity in general could be impeded, should the transition not proceed smoothly. In order to achieve a smooth transition and to prevent these concerns from materializing, it was necessary to steadily advance various efforts such as identifying risk-free reference rates, considering alternative interest rate benchmark options, deliberating on transition methodologies, formulating transition plans, and executing the transition itself. In Japan, several meeting bodies were established to address issues specific to each transition phase. These bodies played a central role in pushing forward the initiatives.

As the Forum winds down, this report retrospectively summarizes the objectives, forms of organization, and initiatives by the Forum and its predecessor bodies and highlights their significant role in interest rate benchmark reform in Japan.

2. Reflections on interest rate benchmark reform

(1) Objectives and organization form of each meeting body

a. Study Group on Risk-Free Reference Rates (April 2015 to March 2018)

i. Objectives

The Study Group on Risk-Free Reference Rates (hereinafter "the Study Group") was established to identify JPY risk-free reference rates.

The Study Group aimed to provide necessary deliberations in Japan to develop an alternative interest reference rate that hardly includes bank credit and other related

risks. This was in line with the recommendation made in a report published by the Financial Stability Board (FSB) in July 2014, entitled "Reforming Major Interest Rate Benchmarks" (hereinafter "the FSB report"), which called for the development of such risk-free reference rate in addition to improvement in the reliability and robustness of major existing interest rate benchmarks (IBORs).

ii. Form of organization

The Study Group was a relatively small-sized meeting body, comprised of experts in regard to identifying risk-free reference rates, mainly members from financial institutions that were potential users of risk-free reference rates (such as major banks and securities companies).

b. Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (August 2018 to February 2022)

i. Objectives

The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (hereinafter "the Committee") was established to provide necessary deliberations in order that market participants and interest rate benchmark users could appropriately choose and use JPY interest rate benchmarks in ways suited to the characteristics of financial instruments and financial transactions.

The FSB report recommended the usage of interest rate benchmarks in ways suited to the characteristics of financial instruments and financial transactions, as well as identifying risk-free reference rates. In line with the recommendation, the UK's Financial Conduct Authority (FCA) announced in July 2017 that after end-2021, it would no longer compel panel banks to submit rates used for the calculation of LIBOR, making the cessation of JPY LIBOR even more likely. Accordingly, it became necessary to select alternative interest rate benchmarks and implement the transition away from LIBOR within a limited time frame.

ii. Form of organization

Since the promotion of the appropriate choice and usage of JPY interest rate benchmarks required involvement by the entire market, the Committee was comprised not only of financial institution members of the Study Group but also of a broader range

of market participants, including institutional investors, regional banks, and non-financial corporates. Under the Committee, subgroups (loans, bonds, and development of term reference rates), a working group (currency swaps), and a task force (support of developing the Tokyo Term Risk Free Rate [TORF]) were established to effectively address a variety of practical issues.

c. Cross-Industry Forum on Interest Rate Benchmarks (March 2022 to December 2023)

i. Objectives

The Cross-Industry Forum on Interest Rate Benchmarks was established to exchange opinions on the choice and usage of JPY interest rate benchmarks and to inform its members of trends in interest rate benchmark reform in other jurisdictions and foreign currencies.

After the JPY LIBOR transition in Japan mostly completed and the Committee's activities reaching a juncture in light of its primary objectives, efforts were still required such as addressing remaining issues regarding the JPY LIBOR transition, having discussions for the adequate use of alternative interest rate benchmarks, and supporting market initiatives for the USD LIBOR transition. In light of this, the need to keep the meeting body was recognized, which led to the establishment of the Forum by reorganizing the Committee.

ii. Form of organization

As was the Committee, the Forum was comprised of a broad range of market participants. To lighten the burden on participants, there were no subgroups, and the frequency of meetings was reduced to roughly once a quarter.

(2) Initiatives by each meeting body

a. Study Group on Risk-Free Reference Rates (April 2015 to March 2018)

The Study Group held a total of 19 meetings. It identified the risk-free reference rate by holding public consultations and collecting the opinions of market participants. Subsequently, to promote the use of this benchmark, the Study Group worked to develop the overnight index swap (OIS) market and published a guide containing an overview and case studies on JPY OIS transactions with a view to providing

information to a wide range of market participants.

i. Identifying a JPY risk-free reference rate

The Study Group issued a public consultation document in March 2016, which presented the findings from its works and invited comments from market participants. Based on the results of the consultation, the Study Group identified the uncollateralized overnight call rate (TONA) as the JPY risk-free reference rate. In December 2016, the Study Group published "Report on the Identification of a Japanese Yen Reference Risk-Free Rate," which summarized the outcome of its deliberations.

ii. Providing information to develop the OIS market

Following the identification of the risk-free reference rate, the Study Group conducted deliberations to develop the OIS market. As part of its effort, it published a report entitled "Japanese Yen OIS: Transaction Overview and Case Studies" (available only in Japanese) in April 2018 to facilitate the understanding of JPY OISs among financial institutions and other interested parties with no prior experience in using such transactions.

b. Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (August 2018 to February 2022)

The Committee held a total of 32 plenary meetings, along with a number of subsidiary meetings. It conducted three rounds of public consultations to solicit the opinions of market participants outside the Committee and collaborated with the public sector -- specifically the Financial Services Agency (FSA) and the Bank of Japan (BOJ) -- to deliberate on measures that could be commonly applied to the entire market. It worked to ensure the smooth implementation of the transition, such as by formulating "Roadmap to Prepare for the Discontinuation of Japanese Yen LIBOR," a reference for market participants, in which a rough timeline was indicated for "significant reduction" of existing LIBOR-referencing contracts. The Committee also carried out questionnaire surveys and published their results to share information on the status of the transition progress among market participants and to facilitate steady progress in the transition.

i. Public consultations (July to November 2019, August to November 2020, September to November 2021)

The Committee held its first public consultation (July to November 2019) to invite market participants' opinions regarding alternative interest rate benchmarks to JPY LIBOR, such as TONA, a term risk-free reference rate, and the Tokyo Interbank Offered Rate (TIBOR). The consultation also laid out the foundation for discussions on active conversion and the introduction of fallback provisions.

While the first public consultation made clear the alternative benchmark options preferred by market participants, the second public consultation (August to November 2020) was launched to solicit market participants' opinions on specific matters to be dealt with when fallbacks are triggered. In line with the first consultation, the second consultation set out frameworks for transition by deliberating on practical issues such as spread-adjustment methodologies for fallbacks.

In addition, as the focus of its discussion shifted to the implementation of transition plans by respective market participants during the "final phase" of the transition, the Committee held its third public consultation (September to November 2021). The consultation considered the treatment of tough legacy contracts that cannot feasibly be transitioned away from JPY LIBOR and specified the points to note in the use of synthetic JPY LIBOR as a safety net. In the meantime, the FSA and the BOJ issued a joint letter entitled "LIBOR Transition based on the *Final Report on the Results of the Public Consultation on the Treatment of Tough Legacy Contracts in Japan* published by the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks" in November 2021. In this letter, they expressed the view that the use of synthetic JPY LIBOR should be in accordance with the results of the consultation, which should be regarded as "market standards."

ii. Roadmap to Prepare for the Discontinuation of Japanese Yen LIBOR (August 2020)

In August 2020, the Committee laid out a transition plan with reference to international discussions. This plan served as a roadmap for market participants in Japan to formulate their own transition plans. It proposed the timelines for achieving transition milestones such as cessation of new contracts referencing JPY LIBOR and significant reduction of existing contracts.

iii. Questionnaire Survey on the Progress in the Transition Away from JPY LIBOR

With JPY LIBOR's discontinuation drawing close, the Committee carried out three rounds of "Questionnaire Survey on the Progress in the Transition Away from JPY LIBOR" (the reference reporting period was end-September, end-November, and end-December 2021, respectively), with a view to facilitating the market-wide smooth transition.

c. Cross-Industry Forum on Interest Rate Benchmarks (March 2022 to December 2023)

The Forum held a total of six meetings. It provided opportunities to exchange opinions on the choice and usage of JPY interest rate benchmarks and share information on trends in interest rate benchmark reform in other jurisdictions and foreign currencies. In light of international discussions, the Forum also worked to support a smooth USD LIBOR transition in collaboration with the public sector. As USD LIBOR's discontinuation approached, the Forum carried out questionnaire surveys on progress in the transition and published their results to share information on progress status and support a smooth transition among market participants.

i. Promoting opinion exchange and information sharing

As part of opinion exchange regarding the choice and usage of JPY interest rate benchmarks, the JBA TIBOR Administration and QUICK Benchmarks Inc., which are the administrators of the benchmarks, gave presentations on their efforts to make TIBOR and TORF more reliable and robust. In addition, the Tokyo Financial Exchange and the Osaka Exchange shared information on the listing of TONA interest rate futures.

Moreover, the Forum was a venue to share information on trends in interest rate benchmark reform in other jurisdictions and foreign currencies, with market participants reporting on the status and challenges of the USD LIBOR transition. In addition, the FSA expressed its supervisory expectations in light of the status of the USD LIBOR transition in Japan and related trends among foreign authorities.

ii. Questionnaire survey on progress in the transition

With USD LIBOR's discontinuation drawing close, the Forum carried out and published two rounds of "Questionnaire Survey on the Transition away from USD

LIBOR and the Usage of Alternative Interest Rate Benchmarks for JPY LIBOR" (the reference reporting period was end-March 2023 and end-May 2023, respectively). The results of the survey revealed the status of progress in the USD LIBOR transition and facilitated steady progress in the transition. With regard to the use of alternative interest rate benchmarks to JPY LIBOR, the Forum followed up on the state of usage and existing challenges through opinion exchange and information sharing.

3. Conclusion

The interest rate benchmark reform in Japan was a substantial undertaking that required resolution of a wide range of issues. Specifically, the LIBOR transition involved extensive deliberation on transition methodologies and the transition of a significant number of contracts. The flexible reorganization of the meeting bodies to address issues specific to each transition phase, including changes in the composition of members and set-up of subgroups, was highly effective, helping to maintain their adequate capacity while securing balanced workloads.

Furthermore, the meeting bodies played the following four central roles during the transition phase.

- ✓ Offering a venue for collecting and exchanging opinions. The meeting bodies collected opinions from market participants, mainly by conducting public consultations. Issues and knowledge were shared via lively exchange of opinions.
- ✓ Providing roadmaps for the transition. The meeting bodies provided market participants with roadmaps for transition by sharing transition plans and information on trends in overseas authorities and carrying out questionnaire surveys on the progress in the LIBOR transition. This served as a driving force for achieving a smooth transition.
- ✓ Collaborating closely with the public sector. The meeting bodies' close collaboration with the public sector (e.g., the FSA and the BOJ) also facilitated an orderly transition.
- ✓ Collaborating with parties overseas. The meeting bodies shared with market participants concerns at international organizations and authorities in other

jurisdictions and informed them of the expected timelines of the transition abroad, making the transition in Japan more aligned with the global transition.

Much of the smooth progress in interest rate benchmark reform in Japan owes to interested parties' collective efforts through the aforementioned initiatives, with the meeting bodies reorganized in a flexible manner to address issues specific to each transition phase. Undoubtedly, this experience would prove beneficial should Japan face industry-wide challenges again in the future.