October 23, 2019

International Swaps and Derivatives Association, Inc.
(via Email: FallbackConsult@isda.org)

Comments on Consultation on Final Parameters for the Spread and Term Adjustments in Derivatives Fallbacks for Key IBORs

Dear Sirs/Madams:

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on *Consultation on Final Parameters for the Spread and Term Adjustments in Derivatives Fallbacks for Key IBORs* published on September 18, 2019 by the International Swaps and Derivatives Association (ISDA).

We respectfully expect that the following comments will contribute to our further discussion.

< General Comments>

1. Consistency across currencies

ISDA has undertaken several consultations on the derivatives fallbacks. We understand the overwhelming majority of respondents to those consultations preferred "compounded risk-free-rates (RFR) setting in arrears" and the "historical mean/median approach," irrespective of currency. This consultation proposes the details of RFR adjustments and the final parameters for the spread adjustment based on the results of these consultations. In finalizing the methodologies for this consultation, we request ISDA to continue endeavor to facilitate consensus-building across market participants to ensure consistency of the treatment across currencies, thereby avoiding any practical burdens.

Consistent treatment across currencies would ensure confidence from wide-ranging market participants and enable smoother implementation of fallbacks, which would contribute to prevent any confusion among market participants.

2. Due considerations to transactions with end users

While ISDA-based derivatives are independent financial transactions, customers other than financial institutions (i.e., end users) often use them integrally with underlying assets for hedge purposes. In particular, many market participants have already raised a concern about the difficulty in applying setting in arrears rates for cash products. In order to promote the sound development of derivative markets, we request ISDA to ensure flexibility in determining a number of Banking Days for implementing setting in arrears rates in consideration of transactions entered into with customers other than financial institutions and operations of cash products to be hedged.

3. Early finalization

The determination of details of parameters for the adjustments in derivatives fallbacks and thereby the finalization of ISDA Definitions will promote preparations, including system modification and development, of market participants. This will eventually accelerate the introduction of fallback provisions in contract for cash products as well, which has been promoted in line with discussions at ISDA. It is therefore desirable to finalize the methodologies at an early stage after taking into consideration feedback to this consultation.

<Answers to the questions>

1. Which option do you support? Please differentiate between different IBORs if views differ. We strongly encourage you to limit your response to the options listed in I and II above. However, if you strongly prefer a different option, please explain that and explain why you prefer it over the options above.

We support option I.

Median over five year lookback period can capture latest economic conditions and is desirable from a perspective of continuity. It is also long enough to reduce the possibility of market manipulation. On the other hand, we think that the ten-year lookback period is not a desirable option for the following reasons: in the case of a SOFR, which has insufficient historical data, for example, the ten-year lookback period may include a relatively large amount of indicative/proxy data, and have difficulties in eliminating arbitrariness for trimming data.

3. Is consistency across IBORs important? Is it critical, very important, somewhat important or not important at all? Please explain.

We believe that consistency across IBORs is critical. The use of different methodologies across currencies is not desirable from a perspective of ensuring the soundness of the derivatives markets, as it can cause confusion across market participants and undermine credibility of the markets.

4. Which is more important to you – your top preference or consistency across IBORs

(assuming you could not have both)? Please explain.

Consistency across IBORs is more important.

5. Should the transitional period described above be included in the spread adjustment?

We prefer not to include the transitional period in the spread adjustment.

This is because operational burdens will be imposed as noted in the consultation, and economic value may not be completely retained even if the transitional period is introduced.

6. Should outliers be excluded? Please explain the rationale for your answer.

We have no specific comment as we support option I.

7. If outliers were to be excluded, to what extent should the data be trimmed?

We have no specific comment as we support option I.

8. If negative spreads have been historically observed for an IBOR/RFR pair, are there compelling reasons to exclude such observations from the calculation of the spread adjustment? If so, what are they?

We have no specific comment as we support option I.

9. Negative spreads can be prevalent for some IBORs. If negative spreads have occurred frequently enough that the spread adjustment is itself negative, are there compelling reasons to not implement a negative spread adjustment?

We do not see any particular problem when the spread adjustment is itself negative.

10. Is it necessary to apply a backward-shift, lockout or similar adjustment to avoid making payments on the same date as the date on which the fallback rate is known? Please note in particular if you would not be able to transact without an adjustment.

If interest payments need to be made on the same date on which the fallback rate is determined, it is difficult for users located in regions with an earlier time zone to conduct such operations as rates for globally used currencies (e.g., USD, EUR and GBP) are published at respective time zone, and thus the feasibility is low.

It is therefore essential to set a difference between the date on which the fallback rate is determined and the interest payment date through the approaches of backward-shift, lockout or similar adjustments.

> 11. If an adjustment is necessary, do you support using a two-Banking Day backward-shift, a two-Banking Day lockout or a different adjustment? Please explain your answer.

For interbank derivatives, an adjustment using a two-Banking Day backward-shift or a two-Banking Day lockout would not be a problem. However, for transactions entered into with end users and for cash products to be hedged, two Banking Days would not be sufficient and the period with more length of time (five or eight Banking Days) needs to be given as a notice for end users needs to be made or operations including arranging for payments need to be conducted.

> 12. Which cities should apply for the purposes of the two-Banking Day backward-shift or lockout?

We think that the concept of "universal Banking Days", described in footnote 27, should be considered because adoption of this concept would not cause significant differences across regions.

Even if this concept is not adopted, cities similar to those referenced in LIBOR should be used to avoid confusion across market participants. In the case of bilateral transactions, cities to which both parties (including back offices) belong should be regarded as a reference relating to the rate.

> 13. Would either option be problematic or would you be able to transact if either option were implemented for derivatives fallbacks? Please explain.

We have no clear preference because either option has advantages and disadvantages as noted in the consultation. We however believe that it is necessary to consider taking some measures for end users and the operations for cash products to be hedged, as well as adjusting holidays and time differences.

> 14. For what products would a two-Banking Day backward shift or lockout not work? Is there any way to address the problems using the "compounded in arrears rate"?

For either option, we believe that it is necessary to consider taking some measures for end users and the operations for cash products to be hedged, as well as adjusting holidays and time differences. For example, in Japan, due to the time differences, the applicable interest rate and the amount of interest would be calculated on only one Banking Day before the settlement date, which could result in extremely tight operations.

15. Is it problematic to use the Calculation Period instead of the IBOR period?

We do not see any particular problem.

16. Is two Banking Days the correct length of time for a backward shift or lockout? If not, what is the correct length of time?

While we understand that two Banking Days, which is a rather short period of time, is preferred to appropriately reflect the interest calculation period for lockout, we recognize some transactions with customers other than financial institutions require five or eight Banking Days as we responded to Question 11 above.