December 19, 2014

To the ICE Benchmark administration

Japanese Bankers Association

Comments on "POSITION PAPER ON THE EVOLUTION OF ICE LIBOR" issued by the ICE Benchmark administration

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on POSITION PAPER ON THE EVOLUTION OF ICE LIBOR released on October 20, 2014 by the ICE Benchmark administration (the "IBA").

We respectfully expect that the comments in attached paper will contribute to your further discussion on this issue.

As described in the comments in attached paper, JPY LIBOR is widely used for calculating present value of financial instruments such as securities (discount factor), for calculating a base rate for a loan and payment amount for derivative transactions, as well as for internal management purposes including a transfer price between the head office and branch, and market transactions and its risk measurement. JBA considers that the discontinuation of JPY LIBOR therefore has a significant impact, and hence survival of JPY LIBOR even after the reform is important.

Comments on Position Paper on the Evolution of ICE LIBOR

Corresponding Section in Position Paper	Comments
5.7 To promote the objectives mentioned in section 2.2, together with improving benchmark integrity and transparency, IBA proposes a number of parameters to standardise the inputs to LIBOR. These will align the three elements from 2.1 (LIBOR's name, its question asked and market practice), to make the benchmark more formulaic and minimise the need to use expert judgement.	■ JPY LIBOR is widely used for calculating present value of financial instruments such as securities (discount factor), for calculating a base rate for a loan and payment amount for derivative transactions, as well as for internal management purposes including a transfer price between the head office and branch, and market transactions and its risk measurement. The discontinuation of JPY LIBOR therefore has a significant impact, and hence survival of JPY LIBOR even after the reform is important. Consequently, designing a highly transparent benchmark with a sufficient robustness that enables to be widely used is considered to be important. ■ While we agree that enhancement of integrity and transparency is necessary, it is also a major concern from a practicable perspective for users whether continuity of a benchmark will be ensured, or any changes occur, before and after the benchmark reform. IBA should specify measures to be taken to address any change in the benchmark due to the introduction of a standardised methodology (e.g. a change in the interest rate level), as well as to minimize such a change.
5.7.1 Eligible transactions: Setting a transaction-based rate via a formulaic approach in the calculation process cannot work effectively in illiquid markets when benchmark submitters must rely on expert judgement to determine their submissions. In the UK benchmark regulation, 3 the FCA requires a benchmark submitter to LIBOR to ensure that its benchmark submissions are determined using an effective methodology on the basis of objective criteria and relevant information.4 The FCA states that "an effective methodology for determining benchmark submissions in addition to quantitative criteria may include the use of qualitative criteria, such as the expert judgment of the benchmark submitter". Box 4.B of the Wheatley Review contains the current LIBOR submission guidelines and the current hierarchy of acceptable transaction types. IBA proposes that; submitters' unsecured wholesale funding deposits, Commercial Paper and primary issuance Certificates of Deposit should be directly included other transaction types, such as OIS, Repos, FX Forwards, FRAs and FRNs should only be included when a bank's lack of direct transactions means that the submitter has to rely on expert judgement. Anchoring ICE LIBOR further in transactions would fulfil the strategic objectives set by the FSB and will bring a number of advantages: minimising the use of qualitative expert judgment in favour of verifiable and auditable data	■ The scope of eligible transactions should be determined on a currency-by-currency basis in accordance with each financial institution's business nature, type and practices. ■ IBA is requested to clarify the order of priority, if any, among inter-bank unsecured lending/funding, unsecured wholesale funding deposits, Commercial Paper and primary issuance Certificates of Deposits, and if the priority exists, the details of such priority. Further, the treatment of executable bids and offers should be defined. ■ With regard to direct inclusion of CP and CDs in determining benchmark submissions, IBA should give due consideration to the type of currency and different situations across the financial centers where the currencies are mainly traded. (e.g. Counterparties in deposits/CD transactions and interbank transactions may differ considerably between the case of U.S. dollars for which funding entities constantly exist, such as Japanese banks, and the case of Japanese yen for which a funding demand is constantly significantly low against the background of excessive deposits.) (Example 1) U.S. dollar transactions －In some cases, data of actual transactions with a term of longer than 3 months are not available, including CP/CD. While it is recommended in the position paper that location be expanded to increase the number of available transaction data, IBA should also consult benchmark users about a negative impact that may arise from doing so (see our comment on paragraph 5.7.3). －Further, it should also be considered whether there is any negative impact arising from a benchmark that relies heavily on transaction data (see our comment on paragraph 5.7.9). (Example 2) Japanese yen transactions －In Japan, CD rates serve more to provide investment opportunities to customers against the backdrop of excessive deposits of Japanese banks, and tend to reflect individual business relationships between the bank and the customer. Particularly in the case of CD transactions with non-financial corporations, it would be difficult to

significantly reducing regulatory risk to submitting banks, making their submissions less susceptible to manipulation and maximising Benchmark submitters' ability to justify evidentially the basis for their submissions. This in turn will potentially restore the submitting banks' wish to participate in setting LIBOR and over time attract new banks wanting to play their part by providing transactional data to IBA for the compilation of LIBOR. We note that some weightings, premia or discounts may need to be applied to additional transaction types.	treat CD rates as a general funding rate because this type of transactions include those transactions that can be executed based on relationships a commercial bank has built with individual non-financial corporations and also because the non-financial corporations may take into account the deposit share of their banks. Further, such deposits apply different processes to determine rates, giving rise to a significant gap in terms of, among other things, the method to obtain data and the timing when data can be obtained (see also section "Reference" below) [Reference] ■ Generally in Japan, unsecured wholesale funding deposits and issuance Certificates of Deposit is categorized into the following two types: i) a transaction directly executed by certain responsible personnel in a front office; and ii) a transaction for which RM personnel at a sales unit or branch offers a rate at his/her discretion according to certain rules (e.g. a threshold rate should be the internal transfer rate). ■ In the latter case ii), RM personnel often determine rates at his/her discretion by using business judgement, irrespective of daily movements of money markets. Further, there are many challenges as to the effectiveness of data collection in the latter case because there is no business practice to determine the time of execution of transactions and because required data elements for LIBOR+ cannot be obtained by the next business day due to system-related constraints in some cases.
5.7.2 Waterfall approach: IBA is committed to evolving LIBOR as quickly as possible to a rate that is: ● generated from observable market transactions to the greatest extent possible, and ● calculated from submissions derived from transactions executed by banks in the wholesale unsecured market. Where there are insufficient transactions to produce a reliable submission, a waterfall methodology should be followed, using pre-defined parameters specified by IBA from time to time in consultation with our LIBOR Oversight Committee, as follows; ● where transactions are not available for a currency and tenor, or are below minimum transaction size or aggregate volume, interpolation techniques should be utilised, and ● if interpolation is not possible then expert judgement should be used as a fall-back of last resort.	■ To better differentiate from the whole unsecured market, it is recommended that the term "observable market transactions" to be modified to "observable money market transactions." ■ Transactions in the wholesale unsecured market would be considered funding through the market by a bank if direct submissions by a front office are referenced. It should however be noted that inconsistencies in this phased benchmark determination process may also arise across panel banks because of differences in their processes/procedures and ways of thinking in relation to the use of waterfall approach. ■ If interpolation techniques are utilised for all cases to calculate a rate for a tenor with limited volume of actual transactions which include those existing transactions whose duration ends in the following year or period, it may cause distortion of the yield curve and thus expert judgement needs to be used. (e.g. When determining a rate for a 3-month tenor on December 20, all of the maturity of existing actual transactions fall after April 1.) This case therefore should be illustrated as an example of "if interpolation is not possible".
5.7.3 Location: Location refers to the financial centres from which benchmark submitters derive their transactional data. The chosen locations currently depend in part on the level of activity within the banks' corporate groupings and on their corporate structure.	■ While we understand the purpose of expanding locations, IBA should further assess the reasonableness of doing so in reference to views collected from benchmark users because there are some concerns as described below: (i) Rates applied to actual transactions vary by location even if the currency is the same because liquidity and participants differ across markets. If data of such actual transactions are aggregated to derive a benchmark

IBA proposes that eligible transactions booked in the primary funding centres should be used by benchmark submitters. The relevant centres should be determined by each bank individually and agreed with IBA as administrator. The submitter's lesser activity in other financial centres would not be included; this is for a number of reasons – transactions from other funding centres would be less representative of the bank's funding cost; they would be less likely to be driven by the bank's funding desk; and they could introduce complexity of collection that could be prone to error. It is noted that including multiple funding centres could entail using transactions from domestic as well as offshore funding centres for each currency.	according to London Time, LIBOR may depart from prevailing market rates in each location. (Example) The interest rate level for U.S. dollars differs between London and New York in some cases, and some banks depend largely on U.S. transaction data. In such circumstances, LIBOR submissions for U.S. dollars of the day are highly based on transactions executed in the U.S. in the previous day due to a time-zone difference and other factors. As a result, a rate that deviates from both the London and New York market rates will be published as LIBOR of the day, and may be applied to contracts that reference LIBOR. (ii) Given a time-zone difference related to the timing of calculating the above actual transactions, it would be hard to consider that the rates for U.S. dollars and Japanese yen represent a rate of the same day. (iii) For eliminating an issue which may arise from a timing difference and a difference in the business day, it is considered more effective to state as "the primary funding centres should first be chosen from locations in Europe including London. If sufficient liquidity cannot be observed in the chosen location, then each panel chose a primary funding centres of the related currency".
5.7.4 Counterparties: LIBOR was formed to be a gauge of unsecured funding for banks which was, to a very great extent, driven by inter-bank activity prior to the financial crisis. Activity in that market has since decreased markedly and banks consequently need to expand their sources of unsecured funding to other professional counterparties (including, for example, Sovereign Wealth Funds and Money Market Funds). To be consistent with the original purpose of LIBOR and to reflect the changes in bank funding in recent years, all wholesale and professional entities should be regarded as eligible counterparty types, including central banks and large corporates.	■ If locations will be expanded and supporting data for Japanese yen LIBOR will be required to directly include transaction data of CD/CP executed in Japan, IBA needs to give due consideration to actual situations in Japan (e.g. quantitative criteria and size and sector of counterparties) in defining, in particular, wholesale funding. ■ Whether there is the order of priority among counterparties (e.g. banks, non-bank financial institutions, Sovereign Wealth Funds, Money Market Funds, central banks and large corporates), and if exists, the details of such order should be clarified. ■ Data collected in Japan would include unsecured wholesale funding deposits and issuance Certificates of Deposit executed by RM personnel at a branch located in a local city in Japan. It is not however considered reasonable to determine LIBOR by referencing rates on these transactions. ■ The term "large" of "large corporates" should be explicitly defined.
5.7.5 Timing of transactions: In determining their submissions, benchmark submitters' methodologies may take into account transactions within a time window to include a representative range of transactions. We propose that benchmark submitters should include all of their eligible transactions since their LIBOR submission on the previous business day. This should allow the benchmark to be anchored as far as possible in transactions. It may be appropriate to apply weightings according to whether the transactions were executed on the day of the submission or the previous business day.	■ The primary financial centres for JPY are London and Tokyo. For Tokyo, however, the system of some financial institutions may not be capable of providing wholesale unsecured market data on the following day of the trade date. Accordingly, it is considered to be an issue, in terms of benchmark design, if transactions used as a reference vary across financial institutions.
5.7.8 Interpolation and extrapolation: Interpolation and extrapolation techniques are currently used where appropriate by benchmark submitters according to formulas they have adopted individually. We propose that inter/extrapolation should be used: 1. When a benchmark submitter has no available transactions on which to base its	■ Given a significant impact that a reduction in tenors has on financial instruments using LIBOR, no further reduction of tenors should in principle be implemented as part of the LIBOR reforms, unless actual transactions available for a particular tenor are insufficient and (i) thus a benchmark submitter has to rely on extrapolation techniques and (ii) benchmark user's needs for such a tenor is scarce.

submission for a particular tenor but it does have transaction-derived anchor points for other tenors of that currency, and 2. If the submitter's aggregate volume of eligible transactions is less than a minimum level specified by IBA. To ensure consistency, IBA will issue interpolation formula guidelines.	
5.7.9 Expert Judgement: Qualitative criteria, such as the expert judgment of the benchmark submitter, is currently used to a greater or lesser extent when banks have insufficient transactions to support a reliable submission based on pure quantitative data. In these instances, a submitter can use expert judgement to derive a submission from related transactions or alternatively, if no transactions are available, then expert judgement is more subjective and based off market data and other market indicators. In either case, the submission and supporting data is reviewed by both additional individuals at the submitting bank and also the surveillance team at IBA. In evolving LIBOR, the use of qualitative criteria such as the expert judgment should only have a place as a fall-back of last resort.	■ Although IBA recommends that "expert judgement should only have a place as a fall-back of last resort," expert judgement is a pricing method widely used for transactions executed in the markets. While LIBOR is based on actual transaction data, it needs to be understood that those actual transactions are based on bids and offers which are derived by the use of expert judgement. All things considered, the use of "last-resort" expert judgement should not be viewed as a simple issue and related discussions should not be taken lightly. Simple calculation of a benchmark rate purely based on actual transactions may result in a benchmark design whereby the volatility of the rate may increase due to the type of market and daily changes in offer and bid rates underlying the calculation and hence may undermine user convenience. Consequently, a reduction in volatility by the use of expert judgment should be considered.
6. LIBOR calculation	■ There are various possible methods for aggregating submissions to calculate LIBOR. Characteristics of the current and alternative calculation methodologies need to be specified and specific examples should be given to show, for example, differences in the calculation outcomes. ■ Removing rates which are more than 5% away from the median values may, if this approach is adopted, lead to an unexpected increase in structural volatility in the event that, for example, polarisation of panel banks occurs. IBA is requested to provide its view on how to respond to such cases.
7. Delayed publication of individual submissions	■ Overall, maintaining the process of the delayed publication of individual submissions is considered to be meaningful; and therefore, we generally support this process. Given that these individual submissions are based on actual transactions, it is considered that they need to be published on an anonymous basis.
8. Panel composition	■ It is recommended that IBA should first consider increasing the number of panel banks in the London market. ■ Basically, we support the IBA's basic position to encourage banks to participate in the LIBOR panels on a voluntary basis. In order to increase the volume of actual transaction data, it would be preferable if the number of banks which contribute their transactions increases to about 50 as stated in the position paper. However, it is considered as unlikely that more banks will participate in the LIBOR panels voluntarily given the current framework of LIBOR operation. In Japan, only a limited number of Japanese banks other than those currently acting as a panel bank would be capable of establishing processes and procedures set out in the LIBOR Code of Conduct. ■ In the event that the number of panel banks is increased to about 50, medium-sized banks would be included in the LIBOR panels. In such a case, if the current methodology is used and LIBOR rates are calculated by simply

	averaging submissions, the nature of the benchmark may change considerably. In order to support LIBOR submissions by actual transaction data, related issues need to be considered together with the issue of establishing a framework that ensures a certain degree of continuity when shifting from the current to new LIBOR. For example, with regard to an increase in the number of panel banks, IBA could consider assigning a weight to data submitted from larger banks which have more actual transactions and data from smaller banks which engage in only a couple of transactions.
9. Usage of LIBOR	■ Specific transition methods from the current to new benchmark should be stipulated.