March 28, 2019

The Secretariat of the
ICE Benchmark Administration
(via email: IBA@theice.com)

**Comments on the *U.S. Dollar ICE Bank Yield Index***
**issued by ICE Benchmark Administration**

Dear Sirs/Madams:

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on "the U.S. Dollar ICE Bank Yield Index," published on January 24, 2019 by ICE Benchmark Administration (IBA). We respectfully expect that the following comments will contribute to your further discussion.

**1. General Comments**

It is our understanding that a full transition to a risk-free rate (RFR) (Secured Overnight Financing Rate: SOFR) is being pursued through vigorous discussions by the Alternative Reference Rates Committee (ARRC) in the U.S. in consideration of a possible permanent cessation of LIBOR after the end of 2021.

On the other hand, as indicated in the report, *"Reforming Major Interest Rate Benchmarks"* published by Financial Stability Board (FSB) in July 2014, IBOR is preferred for loans as it reflects credit risk of banks. Like this, a preferred interest rate may vary depending on products. Particularly for loans and other similar cash products, there are strong needs for forward-looking term rates. Given this, currently in the U.S., the development of a SOFR-based term rate is being discussed in preparation for a possible permanent cessation of LIBOR and is expected to be available soon. In such circumstances, non-ARRC members including JBA particularly are concerned about how much earlier the development of such rate can be available than the end of 2021, which is indicated as the schedule in the ARRC's Paced Transition Plan in order to achieve smooth transition from LIBOR.

We consider that the U.S. Dollar ICE Bank Yield Index (ICE BYI) proposed by IBA takes into account interest rate characteristics that are preferred for cash products. From the perspective of developing financial benchmarks as social infrastructure, it would be preferable for various benchmark users, including retail and corporate borrowers, to have multiple options available and select a rate from such options depending on respective purposes, products, preferences and other relevant factors. It is therefore important to establish several options of interest rates that meet various needs of market participants (both borrowers and lenders).

Given the above, we support the development of ICE BYI as one of benchmarks available in the cash markets under the condition that it does not undermine sound transition to RFR including the forward-looking term SOFR. Please refer to the followings for more details of our reasoning.

**(1) Needs for forward-looking term rates**

In business practice of indirect finance, a bank notifies the interest rate amount and other necessary information to borrowers in advance so that they can prepare for the payment of interest, etc., and hence there are constant and strong needs for forward-looking term rates. As it is not fully clarified when a SOFR-based term rate will be developed and introduced at the moment, in order to avoid the risk of LIBOR cessation at an earlier stage, it should not remove the possibility of developing the ICE BYI that can provide a forward-looking term rate to end users.

**(2) Easier to understand for end users**

In indirect finance where financial institutions often negotiate with end users, which are non-financial institutions, it would be important to have an interest rate that is easy to understand especially for borrowers in order to ensure an agreement is smoothly reached between the parties. From this viewpoint, an interest rate structure "Interest rate benchmark (that includes risk premiums associated with funding in the entire banking sector) + Spread (that reflects borrower's credit premiums and risk premiums associated with funding of individual banks)," which is consistent with LIBOR-based structure, is functional.

In the case of the proposed ICE BYI, we consider that this rate is intended to represent the average funding rate of banks (i.e. lenders). In this perspective, it can be said that ICE BYI is consistent with LIBOR. Therefore, it is easy for borrowers to understand the interest rate applied that includes the spread. This, combined with the fact that borrowers in indirect finance are familiar with such a structure, would help avoid confusion arising from the benchmark transition and would meet the needs of users who desire to reduce LIBOR exposures at an early stage before LIBOR is discontinued.

**(3) Convenience for banks**

The ICE BYI would be highly convenient not only for borrowers but also for banks (i.e. lenders). For example, since the ICE BYI has similarities in components of the interest rate with LIBOR, banks will be able to retain the concept of spreads or risk management approaches established on the basis of LIBOR. In this regard, the ICE BYI would incur lesser burdens arising from changing the current practice. This will reduce burdens of, in particular, small- and medium-sized financial institutions in appropriately managing and addressing uncertainties relating to the transition from LIBOR to alternative rates.

**(4) Robustness of the benchmark**

One of the major concerns of LIBOR has been its excessive reliance on "expert judgment." The proposed ICE BYI, on the other hand, is underpinned entirely by data of actual transactions of large, internationally active banks in multiple markets. This means that the ICE BYI is more robust than LIBOR since it does not allow expert judgment of panel banks.

As discussed above, since the ICE BYI meets needs of both borrowers and lenders and it increases robustness relative to LIBOR as discussed above, we believe that the development of the ICE BYI would be useful. There are, however, areas requiring further improvement: (i) it will place the same level of burdens of panel banks on large financial institutions since they will need to submit data continuously as in the case with LIBOR, (ii) it is required to take into consideration the "Principle 7: Data Sufficiency" of IOSCO's *Principles for Financial Benchmarks*.

In the following section, we respond to IBA's specific questions based on the "1. General Comments" discussed above.

## 2. Answers to the Specific Questions

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| 1 | Do you agree that the U.S. Dollar ICE Bank Yield Index will be representative of the average yields at which investors are willing to invest U.S. dollar funds on a senior, unsecured basis in large internationally active banks operating in the wholesale U.S. dollar markets? |

(Answer)

We agree with the proposal under the condition that transaction data are provided by financial institutions in a stable manner and resulting rates are representative of the average funding rate of banks that LIBOR originally intends to represent.

(Rationale)

The ICE BYI can be construed as a benchmark with enhanced reliability and robustness relative to LIBOR because its calculation entirely relies on actual transaction data of large, internationally active banks. Therefore, it could be a representative U.S. dollar-denominated benchmark that incorporates credit risk of banks. However, to ensure this, transaction data that underpins the calculation of the ICE BYI needs to be provided sufficiently and continuously. For this purpose, IBA will need to enter into an agreement with financial institutions pertaining to submission of transaction data.

Furthermore, as benchmark users in the cash markets want to minimize the transfer of economic value arising from the change in the benchmark, it is necessary to retain the continuity from LIBOR to a certain extent by ensuring that the new benchmark is representative of the average funding rate of banks that LIBOR originally intends to represent.

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| 2 Do you agree that the U.S. Dollar ICE Bank Yield Index should be published for one-month, three-month and six-month tenors, or should other tenors be included? |

(Answer)

We agree with the proposed three tenors. In addition, we would like to request IBA to publish for a one-week tenor.

(Rationale)

If the one-week tenor is published in addition to the three tenors, banks can use rates that better reflects actual market conditions when calculating interest rates on loans with the maturity of less than one month by the linear interpolation method.

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| 3-b Should IBA seek to address or exclude outlier transaction yields when constructing the yield curve, either through the use of a robust regression model or by imposing a +/- 100bps sensitivity test relative to the calculated curve? |

(Answer)

To the extent necessary to stabilize the benchmark level, it is preferable that some adjustments be made to outlier transaction yields.

(Rationale)

Eliminating outliers is expected to reduce the influence of conditions unique to some market participants and the possibility of manipulation, and thereby stabilizes the benchmark. Specific examples of adjustments include eliminating a certain percentage of the highest and lowest data or eliminating those data that are higher or lower than the median value by certain times (e.g. more than 1.5 times higher or more than 0.5 times lower), instead of eliminating data based on the absolute value of an interest rate differential. It is however necessary to conduct a test sufficiently because such elimination of outliers may conversely undermine the level of the benchmark's representation of actual market conditions.

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| 4 | Do you agree with a target of ten (10) transactions per maturity range, or should this target be increased for some/all maturity ranges? When responding to this question please consider the curve-fitting methodology, which incorporates all eligible data points across the curve on any given day to construct a "best fit" yield curve. |

(Answer)

We agree with the target. It is also necessary to further consider actions to be taken when the target cannot be achieved due to a decline in the transaction volume.

(Rationale)

In order to ensure the stable rate calculation, a target number of transactions should be set at a number that is achievable in consideration of the number of actual transactions.

On the other hand, from the perspective of ensuring the benchmark reliability and robustness and preventing insufficient transaction data from widening the range of fluctuations in daily interest rates, it would be necessary to consider how to secure transaction data when the transaction volume is not sufficient to calculate the benchmark.

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| 5. | Do you agree with using eligible transactions from input windows for up to five (5) previous calculation days where the target number of transactions for a particular maturity range is not achieved using only the input window for the current calculation day? Would it be more appropriate to use transactions from a greater/smaller number of previous days' input windows for any or all of the maturity ranges where the target is not achieved using the current day's window? Would it be more appropriate to use transactions from previous days' input windows irrespective of whether the target is reached using the current day's window? |

(Answer)

We agree with the proposed approach.

(Rationale)

Referencing historical data is expected to enhance the robustness and stabilize the interest rate level, and thereby ensures continuity. With respect to appropriate calculation days, we cannot comment on it unless data showing impacts on the interest rate level caused by changes in the reference period is provided.

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| 7 Do you agree that transactions from input windows for previous calculation days should be given a lower weighting than transactions from the current day's input window? Do you have any comments on the weightings suggested? |

(Answer)

We agree with the proposed approach as it will reflect actual market conditions. However, from the perspective of ensuring the continuity from performance of historical benchmarks, we do not support changing the weighting without a careful consideration once such a weighting is decided..

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| 8 Where transactions from input windows for previous calculation days are allocated to a maturity range, is an OIS-based adjustment sufficient or should other factors be taken into consideration? |

(Answer)

An OIS-based adjustment would be appropriate provided that the liquidity of OIS market is sufficient. However, there may be an issue if this adjustment intends to reflect a risk-free based market volatility while the risk premium portion remains unchanged from the previous day. Under a stressed situation where RFR and risk premium move in opposite directions (i.e: RFR declines and risk premium increases), the proposed approach would make an adjustment only for the move of RFR. In such a case, we believe that a practical approach would be to simply use the interest rate of the previous day.

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| 9 Do you agree that no single bond issuer should be able to represent more than ten (10) percent of the number of bond transactions used to construct the U.S. Dollar ICE Bank Yield Index for any given calculation day? |

(Answer)

We agree with the proposed approach because it is not preferable to unduly reflect conditions of transactions unique to some market participants.

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| 10 Should IBA include transactions for bank holding companies in any circumstances? For example, should the methodology include the holding company debt of Goldman Sachs Group Inc. and Morgan Stanley or The Bank of New York Mellon Corporation given their business profiles and the minimal amount of bond issuance at the bank operating company level for each of these institutions? |

(Answer)

From the perspective of ensuring the robustness of the benchmark, IBA should consider using bonds issued by bank holding companies. In doing so, IBA should take certain measures, such as establishing a cap of 10% (see Q9), to ensure that the average funding rate of banks will be appropriately calculated because it is not preferable to unduly reflect conditions unique to some market participants. In addition, recent developments in banking regulation should also be taken into account.

(Rationale)

It is preferable to include bonds issued by bank holding companies into the benchmark calculation because it is expected that an increased number of referenced bonds will enhance the robustness of the benchmark. However, in the case of a holding company having a non-bank subsidiary, risks of the subsidiary will also be reflected, and therefore if data of bonds issued by such a holding company is excessively used, the prevailing average funding rate of banks that the ICE BYI intends to represent may not be achieved. In this view, IBA should appropriately select bonds data to be referenced.

Furthermore, taking into account that most of G-SIBs are required to hold senior debt instruments issued by holding companies under the TLAC regulatory framework, it should be noted that senior debt instruments issued not by bank subsidiaries but by holding companies may increase going forward.

11 Please provide feedback on any of the eligibility criteria for:

a. Primary market funding transactions (i.e. transaction type, counterparty type, funding location, transaction size, minimum number of transactions, minimum number of counterparties) ; and

b. Secondary market bond transactions (i.e. bond type (coupon type and call eligibility), coupon range, bond issuance size, transaction size, days to maturity of bond).

(Answer)

With respect to the eligibility criteria for the primary market funding transactions (“a”), IBA could consider relaxing the transaction size criteria in order to increase the number of transactions that can be referenced.

12 Should IBA use evaluated prices and associated yields for bonds that otherwise satisfy the input data eligibility criteria for the Index but in respect of which there are no secondary market transactions that are eligible for the purposes of constructing the yield curve for a particular calculation day? The purpose of incorporating evaluated prices would be to expand the input data set that is used to calculate the Index on any given day (note that evaluated

prices are widely used in the calculation of fixed income benchmarks incorporating corporate bonds given the liquidity characteristics of the corporate bond market).

(Answer)

While the proposed approach is, by nature, not preferable, we consider it to be a practical option.

(Rationale)

A situation where the publication of interest rate benchmarks is ceased due to, for example, an extreme reduction in market liquidity, should be avoided even in a short period of time, and the stable calculation and publication of daily rates should be prioritized.

13 Do you agree with publishing the U.S. Dollar ICE Bank Yield Index daily in the morning New York time on the day following the day in respect of which the yield curve is calculated?

(Answer)

Although we have to see how the market practice will be, if the interest rate tenor starts from the two business days after the calculation date, interest rates should be published by 6:45a.m. New York Time on the following date of the calculation date at the latest, similarly to current practice of LIBOR.

(Rationale)

Retaining current LIBOR practice would not basically incur operational issues and rather enhance the convenience of benchmark users, and thereby help revitalize transactions referencing ICE BYI.

14 Should the administration and calculation of the U.S. Dollar ICE Bank Yield Index be undertaken in the United Kingdom, in the United States or in another jurisdiction?

(Answer)

We have no particular preference of which jurisdiction should undertake the administration and calculation provided that benchmarks are linked to various derivatives including interest rate swaps and currency swaps, and holidays in London and New York and time differences are adjusted using a standardised approach.

15 Please provide any other feedback you have on the U.S. Dollar ICE Bank Yield Index or its methodology.

(Answer 1)

The term sheet in Appendix D should take into account adjustments related to holidays.

(Rationale)

If the number of days assumed in Appendix D does not count holidays, instability of resulting indices may be increased, as data supposed to be included is not considered.

(Answer 2)

In order to enhance robustness of the indices, it is preferable to consider expanding markets and transactions which the calculation of indices rely on. Potential approaches include, for example, (i) introducing a waterfall methodology, and (ii) adding referencing products such as senior bonds issued by holding companies to a lower level or adding them to the scope of a referencing data in the case of contingency.

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| 16 Please provide any feedback you have on IBA's proposed timeline and next steps for the launch of the U.S. Dollar ICE Bank Yield Index. |

(Answer)

Feedback from market participants on the use of ICE BYI as an interest rate benchmark should be published as soon as possible. On the other hand, we support the proposed timeline since the index methodology should be finalized by the end of September, after careful discussions and testing based on comments received.

We also request IBA to clarify other matters that users should understand for using the ICE BYI as an interest rate benchmark as soon as possible, taking into account a preparation period required for users to establish their practice.

(Rationale)

We suppose it will take at least half a year for users of interest rate benchmarks to make necessary preparations. Therefore, if the ICE BYI is to be used from 1Q of 2020, IBA should provide its direction on whether the ICE BYI will be used as an interest rate benchmark or not, prior to the proposed timing of finalizing the index methodology.