May 31, 2019

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

Comments on the *U.S. Dollar ICE Bank Yield Index Update*
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 Update," published on April 10, 2019 by ICE Benchmark Administration (IBA). We respectfully expect that the following comments as well as the comments we submitted in March[1] (the "Initial Comments") will contribute to your further discussion.

As noted in the Initial Comments, we support the development of U.S. Dollar ICE Bank Yield Index (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. This is because the proposed ICE BYI is a benchmark that takes into account interest rate characteristics that are preferred for cash products.

Based on the feedback received from market participants including JBA, this update makes proposals on a wide range of issues, including the eligibility criteria, weightings, calculation methodologies, and contingencies. We respond to IBA's Updated Feedback Questions, from a perspective of ensuring further robustness of the benchmark, as follows.

Answers to the Questions

(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? Is a shorter tenor required for stub calculations, or could a different overnight rate be used for this purpose?

(Answer)

We would like to request IBA to publish ICE BYI for a one-week tenor.

[1] https://www.zenginkyo.or.jp/fileadmin/res/en/news/news190328.pdf

(Rationale)

As with the case of LIBOR, publication of one-week tenor enables banks to calculate interest rates for odd-days tenor with the maturity of less than one month, which has strong needs from users, by the linear interpolation method in a way that reflects actual market conditions appropriately.

We think that it is practicable to publish a one-week tenor which is anchored by sufficient actual transactions, as a substantial amount of commercial paper that serves as the basis for data calculation is issued.

(3-c) Should IBA seek to construct a separate credit curve from the input data points and add this back to a notional "risk free" rate curve to generate a composite curve for the Index?

(Answer)

We are concerned that proposed methodology has some risks.

(Rationale)

Based on the proposed methodology, if data required to construct a credit curve is unobservable due to market conditions, the credit curve would remain unchanged regardless of an actual market condition, while a change in the notional “risk free” rate curve may only be reflected.

Specifically, if a monetary easing policy is implemented under a stressed market condition, the credit curve that generally moves upward due to a deterioration in a market condition would remain unchanged while only notional “risk free” rate curve would move downward due to the effects of monetary policy. As a result, there is a concern that a calculated index would be lower than a prevailing interest rate.

This would not only hinder the appropriate reflection of actual market conditions, but also may cause confusion to both lenders and borrowers. We therefore request IBA to reconsider this proposal to avoid such risks.

(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.
Note also that if the requirement for multiple funding transactions with multiple counterparties is removed from the methodology, then the total number of eligible transactions for each calculation day might be expected to increase.

(Answer)

We agree with the proposed target. It is also necessary to further consider actions to be taken when the target cannot be achieved.

(Rationale)

In order to ensure the stable rate calculation, we agree to set a target number of transactions that is limited to some extent and achievable in consideration of the number of actual transactions. As proposed in this update, while it is expected that the target number of transactions will increase considerably due to the easing of the eligibility criteria, it is necessary to continuously consider an action to be taken to ensure the continuity in cases where the transaction volume declines and the number of transactions do not reach ten transactions.

(5-a) 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? Note that the preliminary methodology may utilise transactions in respect of up to five previous calculation days in order to achieve at least the target. If this process results in ten or more eligible transactions for a given maturity range, then no additional previous days' transactions will be utilised but all such eligible transactions will be utilised.

(Answer)

We agree with the proposed approach.

(Rationale)

Referencing historical data to achieve the target number of transactions enhances the robustness and is expected to stabilize the interest rate level appropriately, and thereby ensures continuity.

(5-c) 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)

No, it wouldn’t. We do not think it is appropriate.

(Rationale)

We believe that the approach should focus on appropriately capturing the current day’s actual market. Therefore, if the target can be reached using current day’s window only, there is no need to refer to previous day’s input windows.

(6) Do you agree that primary market funding transactions should be assigned an initial weighting of 100 percent and that secondary market bond transactions should be assigned an initial weighting of 50 percent because funding transactions tend to be of a larger size than secondary market transactions in bank bonds? Would an alternative weighting (e.g. a greater range of weightings of the types of input data used in the construction of the Index to better

reflect variations in volumes seen in respect of the different types of input data) or no weighting be more appropriate?

(Answer)

We agree with the proposed approach to set weightings according to the type of data by sufficiently considering the level of LIBOR that reflected actual market conditions. However, from the perspective of ensuring the continuity from performance of historical benchmarks, we do not support changing the weightings frequently without a careful consideration.

(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)

As commented in the Initial Comments, we believe an OIS-based adjustment is appropriate provided that the liquidity of OIS market is sufficient. However, if this adjustment reflects only a risk-free based market volatility while the risk premium portion remains unchanged from the previous day, a similar issue that we pointed out in (3-c) may occur. Therefore, we request IBA to consider not to reflect risk-free based market changes only.

(10) Should IBA include transactions for bank holding companies in any circumstances (e.g. one which has consistent pricing levels with the operating company level issuance)? 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? What criteria might distinguish the eligibility of bank holding company obligations from operating company obligations (e.g. different business/credit profile or different pricing)?

(Answer)

From the perspective of ensuring the robustness of the benchmark, IBA should consider using bonds issued by bank holding companies. However, an appropriate level of including such factors should be set.

(Rationale)

The more the volume of the bonds is referenced, the higher the robustness of the benchmark would be. Therefore we support the proposal to include bonds issued by bank holding companies into the methodology. However, actual credit rating of a bank holding company is often different from that of its subsidiary banks and in the case of the holding company having a non-bank subsidiary, risks of the subsidiary may be reflected. Therefore, if transaction data of bonds issued by such a holding company is excessively included, 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 used.

(11-a) 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). Should the requirement for multiple funding transactions with multiple counterparties be removed from the criteria and, if so, should the minimum transaction size for individual transactions be varied?

(Answer)

In order to increase the number of transactions that can be referenced, IBA should consider not only relaxing the transaction size criteria but also including large corporate deposits and CDs into calculation, of which terms and conditions are determined in the same manner as interbank market transactions. Since the rate of floating-rate transactions, such as CDs, can be fixed at funding cost on the relevant maturity date after converting the floating rate to the fixed rate at the end date, regardless of the given floating-rate term. Therefore, these transactions could underpin the qualities ICE BYI intends to represent. Furthermore, in most cases, there exist a number of investors behind transactions executed with even a single intermediary firm. We therefore believe it is appropriate to include such transactions in reference data.

(11-b) Please provide feedback on any of the eligibility criteria for:

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). Should floating rate bonds be considered for inclusion in the Index?

(Answer)

As long as appropriate adjustments are made, inclusion of floating rate bonds in the Index contributes to enhancing the robustness. However, floating rate bonds referencing ICE BYI should be excluded because inclusion of such bonds results in circular reference.

(11) Please also provide feedback on the process for varying any eligibility criteria in the future to reflect developments in the market. This would be subject to an appropriate consultation process.

(Answer)

We support the proposal to vary the eligibility criteria after a consultation or other process, which should be held periodically or with adequate frequency, to reflect a change in a market structure in the future. It is however necessary to ensure continuity.

(12) Please provide any comments on IBA's contingency proposals regarding how the Index would be published in the event that insufficient transaction data points are available to

produce the yield curve and generate the one-month, three-month and six-month settings on a given day.

(Answer)

From the perspective of ensuring the continuity of the Index, we welcome that IBA proposed the specific approach for contingency rate calculation because it is desirable to ensure either usual rates or rates under a contingency policy are published for each day. However, there is a concern that the proposed approach would lead to calculating a benchmark that is lower than a prevailing interest rate under a stressed situation, as noted in our answer to (3-c).

(Rationale)

According to the methodology proposed in Figure 8, if sufficient data is not available, the contingency rate may adjust for movements only in 3M RFR and may not reflect a credit spread which is based on prevailing market interest rates. As mentioned in the Initial Comments, the practical approach would be to use the previous day's interest rate (3.00%).

(14) Should any other sources of/types of data be considered for inclusion in the Index?

(Answer)

As described in our answer to (11-a), we request IBA to consider including data of (a) large corporate deposits and (b) variable interest rate transactions such as CDs. It is also desirable to reconsider data sources to be referenced and other items as appropriate when reviewing the Index in the future.

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

(Answer 1)

Along with the case of insufficient data, IBA should consider how to deal with situation where the number of banks providing primary market data has decreased to low and where credit risk of banks providing data has deteriorated. We believe that a contingency plan to address these risks needs to be developed for both the administrator and users of the Index.

(Rationale)

From the viewpoint of the IOSCO Principles, we believe it is necessary to establish a framework at the administrator to maintain stability of ICE BYI as a benchmark. Furthermore, it is necessary for users to develop a fallback clause when referencing ICE BYI as a benchmark.

(Answer 2)

We would like to suggest IBA to consider outreach to borrowers, such as corporates.

(Rationale)

While this update states that IBA is engaged in discussions with large banks, which are lenders, it is necessary for end users, such as corporates, to gain deep understanding on ICE BYI to expand the number of referenced transactions. We request IBA to actively disseminate the differences between RFRs/term RFRs and ICE BYI.

(18) 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)

IBA’s direction on whether the ICE BYI will be used as an interest rate benchmark or not should be announced as soon as possible. In addition, it is desirable to proceed with discussions in the same timeline as proposed in the previous consultation, although this is not specified in this update.

(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, as the first step.