

Fallbacks for the JPY LIBOR Tokyo Swap Rate

Refinitiv calculates and administers the Tokyo Swap Rate (TSR) benchmarks, which are JPY benchmarks similar to the USD LIBOR ICE Swap Rate and the GBP LIBOR ICE Swap Rate. The TSR benchmarks include rates for six-month JPY LIBOR swaps with tenors from one year to 40 years determined using input data from a panel of seven banks (the JPY LIBOR TSRs).

Refinitiv Consultation

Following the FCA's announcement¹ on March 5, 2021 regarding JPY LIBOR's future cessation and/or loss of representativeness after December 31, 2021, Refinitiv has indicated that the JPY LIBOR TSRs will necessarily cease once underlying JPY LIBOR interest rate swap activity stops. Refinitiv therefore recently consulted² on calculation and administration of a new TONA TSR, fallbacks for the JPY LIBOR TSRs and cessation of the JPY LIBOR TSRs.

Pursuant to the results of its consultation, Refinitiv expects to calculate and publish a TONA TSR in September 2021, with a prototype available in August 2021. Refinitiv also expects to publish fallback rates for the JPY LIBOR TSRs in August 2021 based on a formula that is consistent with the fallback calculation for the USD LIBOR ICE Swap Rate and the GBP LIBOR ICE Swap Rate.³ These fallbacks will be based on the new TONA TSR plus the spread adjustment for JPY LIBOR fallbacks in the ISDA IBOR Fallbacks Supplement⁴, with a convexity adjustment to address differences in payment frequency and day count convention. The fallbacks will be intended for use after December 31, 2021 when JPY LIBOR ceases or becomes non-representative. Refinitiv indicated that it will publish the fallback rate on a separate and dedicated page. Refinitiv also indicated that it will work towards the goal of ensuring that the JPY LIBOR TSRs continues to be published up to December 31, 2021 and that it will issue a notice once this is confirmed.

Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks

The Sub-Group for the Development of Term Reference Rates (Sub-Group) of the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (Cross-Industry Committee) recently conducted an evaluation of the results of Refinitiv's consultation and concluded that the approach and formula for fallbacks to the JPY LIBOR TSRs are consistent with the fallbacks suggested by a Subcommittee of the Alternative Reference Rates Committee (ARRC) and the Non-Linear Task Force (NLTF) of the Working Group on Sterling Risk-Free Reference Rates for the USD LIBOR ICE Swap Rate and the GBP LIBOR ICE Swap Rate, respectively.⁵ The Sub-Group also concluded that the fallback could be used for contracts that reference the JPY

¹ <https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf>

² https://www.refinitiv.com/content/dam/marketing/en_us/documents/white-papers/re1384668-ia-whitepaper.pdf

³ <https://www.isda.org/a/N0MgE/ISDA-Announces-Results-for-ICE-Swap-Rate-Fallbacks-Consultation.pdf>

⁴ <http://assets.isda.org/media/3062e7b4/23aa1658.pdf>

⁵ https://www.boj.or.jp/en/paym/market/jpy_cmte/index.htm/. The Sub-Group's conclusions are described in a document posted under "Items" in the "Meeting Materials" for August 26, 2021. This statement assumes that the "Minutes" for August 26, 2021 reflect the Cross-Industry Committee's acceptance of the Sub-Group's conclusions as presented in the posted document and therefore this statement remains subject to change if the "Minutes" do not reflect such an acceptance.

LIBOR TSRs when JPY LIBOR ceases to be published or becomes non-representative after December 31, 2021.

ISDA and the Brattle Group

ISDA commissioned the Brattle Group to independently review the Refinitiv consultation and results thereof. The Brattle Group found that Refinitiv's proposed formula for fallbacks is consistent with the formulas for the USD LIBOR ICE Swap Rate and the GBP LIBOR ICE Swap Rate fallbacks (suggested by the ARRC and the NLTF, respectively) that do not appear to result in economic changes other than those necessary to apply additional precision.⁶ In response to ISDA's recent consultation on these suggested fallbacks, a significant majority of respondents supported them.⁷ ISDA is relying on the Brattle Group's analysis and conclusions, but participants in this consultation should independently form their own views regarding the proposed adjustments.

JPY LIBOR TSR in ISDA Documentation⁸

Section 7 of the 2006 ISDA Definitions contains various 'Rate Options' for the JPY LIBOR TSR. These Rate Options are primarily used as the floating rate in constant maturity swaps (CMS) and CMS-linked derivatives. They include:

- JPY-TSR-Reuters-10:00
- JPY-TSR-Reuters-15:00

Sections 13 and 18 of the 2006 ISDA Definitions also reference the JPY LIBOR TSR as the settlement rate for purposes of (i) determining whether the buyer of a JPY swaption is in-the-money for the purposes of automatic exercise and fallback exercise and (ii) calculating the settlement amount for cash settled JPY swaptions (and certain swap transactions to which optional early termination or mandatory early termination apply).

Implementation of Fallbacks for the JPY LIBOR TSR in ISDA Documentation

In reliance on Refinitiv's consultation, the Sub-Group's conclusions, the Brattle Group's review and its own consultation on comparable fallbacks for the USD LIBOR ICE Swap Rate and the GBP LIBOR ICE Swap Rate, ISDA intends to implement the fallbacks for the JPY LIBOR TSRs. In order to do so ISDA expects to publish amendments to (1) the JPY LIBOR TSR Rate Options listed above in Section 7 of the 2006 ISDA Definitions and (2) the relevant settlement rate provisions in Sections 13 and 18 of the 2006 ISDA Definitions to incorporate the fallbacks. Consistent with the fallbacks in Refinitiv's consultation, these fallbacks will apply if an 'Index Cessation Effective Date' has occurred with respect to JPY LIBOR. If the relevant JPY LIBOR

⁶ See Appendix to the report at <https://www.isda.org/a/v4TgE/Brattle-Report-on-ISR-Consultation.pdf>. ISDA conducted a consultation on the fallbacks suggested by the ARRC and the NLTF for USD LIBOR ICE Swap Rate and GBP LIBOR ICE Swap Rate, respectively.

⁷ <https://www.isda.org/a/N0MgE/ISDA-Announces-Results-for-ICE-Swap-Rate-Fallbacks-Consultation.pdf>

⁸ The description below covers the 2006 ISDA Definitions but the 2021 ISDA Interest Rate Derivatives Definitions, which will take effect later in 2021, also contain the same substantive provisions, albeit in the form of the 2021 ISDA Interest Rate Derivatives Definitions.

TSR is not available (because of either a temporary or permanent cessation) but an Index Cessation Effective Date for JPY LIBOR has not occurred, then the current fallbacks in the 2006 ISDA Definitions will apply.

The fallbacks will first be to a fallback rate that is calculated in accordance with the methodology in the Refinitiv consultation and published by an administrator for reference in financial instruments (i.e., not in ‘beta’ or similar form) at the time the fallbacks apply. If such a published fallback rate is not available at that time, then the fallbacks will be based on a calculation performed by the Calculation Agent in accordance with the methodology in the Refinitiv consultation.

ISDA intends to publish these amendments as a Supplement to the 2006 ISDA Definitions (the substance of which would then be translated into a subsequent version of the 2021 ISDA Interest Rate Derivatives Definitions). Upon publication of such a Supplement and subsequent version of the 2021 ISDA Interest Rate Derivatives Definitions, *all* transactions that incorporate the relevant ISDA Definitions and are entered into on or after the effective date of the Supplement or new version (i.e., the date on which the ISDA Definitions are amended) will include the amended terms (i.e., the updated fallback provisions).

Transactions that incorporate the 2006 ISDA Definitions (or the 2021 ISDA Interest Rate Derivatives Definitions) entered into prior to the effective date of the Supplement or new version of the 2021 ISDA Interest Rate Derivatives Definitions (so called ‘legacy derivative contracts’) will continue to be based on the applicable ISDA Definitions as those ISDA Definitions existed at the time of trading (i.e., before they were amended pursuant to the Supplement or new version), and therefore will not include the updated fallback provisions. However, ISDA also intends to publish template language that counterparties could use to negotiate bilateral amendments for incorporation of the amended terms, and therefore the fallback provisions, in legacy derivative contracts.

ISDA is working with its working groups to prepare drafts of these amendments and expects to publish them, as well as updates to include the new TONA Swap Rate, in October 2021 (provided that the TONA Swap Rate is published for reference in financial instruments by that time). Please reach out to benchmarkreform@isda.org if you would like more information about the draft amendments.