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Financial Law Board

Issues related to Approaches for Handling the Permanent Discontinuation of LIBOR (Summary)[1]

I. Likelihood that LIBOR will be permanently discontinued and approaches thereto

The London Interbank Offered Rate (LIBOR) is calculated based on interest rates submitted by major global banks (i.e., panel banks) operating in the London market and is an average lending interest rate that is published by Intercontinental Exchange as a reference interest rate benchmark[2]. LIBOR is published for five major currencies (i.e., the US dollar, the British pound, the Swiss franc, the euro, and the Japanese yen) and in seven tenors (i.e., overnight, 1 week, 1 month, 2 months, 3 months, 6 months, and 12 months) for each of those currencies, but the likelihood that LIBOR will be permanently discontinued at the end of 2021 is high[3].

LIBOR is used in many cases as a benchmark for calculating interest rates for derivative contracts (such as interest rate swaps) and other instruments with floating interest rates (such as loans for corporations or corporate bonds). If LIBOR is abolished, calculating interest rates for those instruments will no longer be possible.

LIBOR is not only used by financial institutions—it is also used by various users, such as non-financial corporates and institutional investors. Therefore, it is anticipated that if preparations are not made for when LIBOR is permanently discontinued, the impact on users of LIBOR will be very large.

Amidst other countries each devising approaches, in Japan, in July 2019, the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks[4] (the "**Cross-Industry Committee**") published the Public Consultation on the Appropriate Choice and Usage of Japanese Yen Interest Rate Benchmarks[5] (the "**First Public Consultation Document**") as part of considerations that are necessary for appropriately choosing and using a Japanese

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[1] Of the discussions in the Japanese-language paper published on October 23, 2020, by the Financial Law Board with the same (Japanese-language) title as this document (http://www.flb.gr.jp/jdoc/publication58-j.pdf), this document focuses on those about Japanese law related to approaches for handling the permanent discontinuation of publishing JPY LIBOR rates. This is an English-language summary prepared based on information as of the last day of November 2020. In this document, unless otherwise specified, "LIBOR" means "JPY LIBOR".

[2] See the following webpage for details about LIBOR and calculations thereof: https://www.theice.com/iba/libor

[3] In a July-2017 lecture by Andrew Bailey, the former chief executive of the UK's Financial Conduct Authority (FCA), LIBOR's supervisory authority, (Lecture title: The future of LIBOR; https://www.fca.org.uk/news/speeches/the-future-of-libor), he announced that the FCA would no longer use its power to compel LIBOR panel banks to submit rates from the end of 2021. Due to this, the likelihood that LIBOR will be permanently discontinued from the end of 2021 is considered to have rapidly increased.

[4] https://www.boj.or.jp/en/paym/market/jpy_cmte/index.htm/

[5] https://www.boj.or.jp/en/paym/market/jpy_cmte/cmt190702b.pdf

yen interest rate benchmark according to the nature of financial instruments and transactions. And, in November 2019, the Cross-Industry Committee published a summary of the results thereof (i.e., the Final Report on the Results of the Public Consultation on the Appropriate Choice and Usage of Japanese Yen Interest Rate Benchmarks[6]; the "**First Final Report Of Results**"). Moreover, in August 2020, the Cross-Industry Committee published the Second Public Consultation on the Appropriate Choice and Usage of Japanese Yen Interest Rate Benchmarks[7] (the "**Second Public Consultation Document**"), and, in November 2020, it published a summary of the results thereof (Final Report on the Results of the Second Public Consultation on the Appropriate Choice and Usage of Japanese Yen Interest Rate Benchmarks[8]; the "**Second Final Report Of Results**"). With such publications, the Cross-Industry Committee has taken the initiative on approaches for handling loans and bonds[9].

The International Swaps and Derivatives Association ("**ISDA**") has taken a central role in promoting approaches for handling derivative instruments.

Of the approaches for handling the permanent discontinuation of LIBOR, this document attempts to describe procedures for adopting alternative interest rate benchmarks and legal issues relevant to those procedures.

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[6] https://www.boj.or.jp/en/paym/market/jpy_cmte/cmt191129b.pdf. The First Public Consultation Document presents five options as potential interest rate benchmarks to replace LIBOR: Option (1), O/N (overnight) RFR (risk free rate) compound interest (fixing in advance); Option (2), O/N RFR compound interest (fixing in arrears); Option (3), Term reference rates (swap); Option (4), Term reference rates (futures); and Option (5), TIBOR (Tokyo Interbank Offered Rate) (page 7 of the First Public Consultation Document; Appendix 2-a). The O/N rate on which each of Options (1) and Option (2) is based is generally referred to as the "Tokyo Overnight Average Rate (TONA). Regarding Option (3), term reference rates (swap) ("**Term RFR**")), QUICK Corp. ("**QUICK**"), which the Cross-Industry Committee designated as the calculating and publishing entity of prototypes rates for those rates, began publishing prototype rates on May 26, 2020, for market participants and interest rate benchmark users to develop administrative systems, etc. In July 2020, QUICK decided that the official name of this benchmark is "Tokyo Term Risk Free Rate" (TORF), and, on 9 October, 2020, QUICK began publishing prototypes rates on a daily basis (https://moneyworld.jp/page/torf.html). Option (5), TIBOR, is an interest rate benchmark calculated with the same method used to calculate LIBOR, and, currently, the JBA TIBOR Administration is calculating and publishing it. See the following for an overview of this: http://www.jbatibor.or.jp/english/about/

[7] https://www.boj.or.jp/en/paym/market/jpy_cmte/cmt200807b.pdf

[8] https://www.boj.or.jp/en/paym/market/jpy_cmte/cmt201130b.pdf

[9] In the Second Public Consultation Document, the Cross-Industry Committee recommended adopting the waterfall structure in accordance with the below priorities as an alternative interest rate benchmark for loans and bonds.

Loans 1st priority: Term RFR; 2nd priority: O/N compound interest (fixing in arrears); and 3rd priority: A rate that the lender, [after giving due consideration to recommendations by relevant supervisory authorities, etc., or market conventions], accepts as suitable and notifies to the borrower.

Bonds 1st priority: Term RFR; 2nd priority: O/N compound interest (fixing in arrears); 3rd priority: Benchmark recommended by an authority-related committee; 4th priority: Rate set forth in 2006 ISDA Definitions as a replacement benchmark fallback rate; and 5th priority: benchmarks selected by issuers, etc.

These recommendations made by the Cross-Industry Committee are generally supported in the Second Final Report of Results.

II. Procedures for adopting alternative interest rate benchmarks

To specify an alternative interest rate benchmark to LIBOR and use an interest rate benchmark as a substitute for LIBOR, it is necessary to introduce provisions that include, in addition to alternative interest rate benchmarks, certain conditions (i.e., fallback provisions) in contracts for relevant instruments. The following section outlines procedures for introducing those[10].

1. Transition and fallback

Transition and fallback are each an approach to use when adopting an alternative interest rate benchmark.

"Transition" refers to an approach that uses an interest rate benchmark other than JPY LIBOR as the reference interest rate for any financial instrument or transaction for which a contract is newly executed due to a reason such as a legacy contract expiring before LIBOR is permanently discontinued (page 5 of the First Public Consultation Document). And "fallback" refers to an approach in which, for contracts with a contract period that extends beyond the time when LIBOR is permanently discontinued, contracting parties reach an agreement in advance on the replacement reference interest rate for JPY LIBOR to be used after LIBOR is permanently discontinued or other such circumstances (page 5 of the First Public Consultation Document).

In the below discussion, however, only the fallback approach is contemplated. The transition approach is used for new contracts, so the key point is that the parties consent to the contractual content after transition. In contrast to that, in the fallback approach, in addition to consenting to the post-fallback contractual content, it is also necessary to amend the continuing contract's content. Therefore, basically, descriptions about fallback cover descriptions about transition.

2. Procedures to introduce fallback provisions

(1) Loans

For loans, normally, an agreement is reached on contractual content with a loan contract, so a fallback provision will be introduced by amending the loan contract based on the parties negotiating and agreeing.

(2) Bonds

For bonds, corporate bonds are seen as the main subject for deliberations. To introduce a fallback provision to a corporate bond, it is necessary to amend the corporate bond's terms and conditions that determine its details. To amend a corporate bond's terms and conditions, in principle, it is necessary to, in accordance with the provisions of the

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[10] There are legacy contracts that contain interest rate provisions or other such provisions that contemplate the case of LIBOR not being published. But, normally, such provisions assume cases in which publishing LIBOR is temporarily discontinued due to some kind of circumstances arising, so there is a risk that those provisions might not function effectively if LIBOR is permanently discontinued. The below section contemplates cases in which, depending on the legacy contract's provisions, an interest rate benchmark to replace LIBOR is not stipulated and, thereby, it is necessary to amend contracts by using a fallback provisions.

Companies Act, hold a bondholders meeting, pass a resolution for the amendment, and receive approval from a court.

(3) Derivative transactions

For ISDA derivative transactions, it is anticipated that due to market participants carrying out protocol adherence procedures, all legacy contracts executed between market participants will be amended and standardized fallback provisions will be introduced at the same time. For ISDA derivatives, the ISDA has almost completed its cross-currency deliberations. As of October 9, 2020, amendments to the 2006 ISDA Definitions and the final version of the protocol for introducing those amended definitions to contracts executed before the amended 2006 ISDA Definitions went into effect and have been published[11].

However, it is permitted for individuals to reach a consent without adhering to the protocol, and, moreover, parties not adhering to the protocol must individually negotiate and consent to fallback provisions. Therefore, in these cases and for derivative transactions based on contracts other than the ISDA Master Agreement, procedures that are the same as the procedures used for loans will be necessary.

III. Deliberations about issues related to adopting alternative interest rate benchmarks

Numerous legal issues exist in relation to adopting alternative interest rate benchmarks, as described above in II. The following section outlines those issues.

1. Effect of contracts if fallback provisions cannot be introduced

The biggest conceivable problem is what will happen to the effect of relevant contracts if fallback provisions cannot be introduced by the time LIBOR is permanently discontinued. As a basic frame of reference to analyze this point, the following has been stated about contracting parties' reasonable intentions regarding items not clearly set forth in a contract: "The meaning of the parties' intention should be reasonably clarified, taking into consideration the parties' purpose, the circumstances that led to the juristic act, customs, accepted conventions concerning transactions, and the like"[12].

(1) Effectiveness of the contract itself

If fallback provisions cannot be introduced by the time LIBOR is permanently discontinued, LIBOR, which is referenced in methods used to calculate interest rates in relevant contracts, will no longer be available, so a situation will arise in which it will no longer be possible to specify an interest rate to be paid. It is, however, not thought that entire contracts will be invalidated due to this. If an entire contract were invalidated, in the case, for example, of a loan contract, at the same time as the

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[11] For material published by ISDA on October 9, 2020, see the following link: https://www.isda.org/2020/10/09/isda-board-statement-on-the-ibor-fallbacks-supplement-and-protocol/. Also, see the following link for details thereof: https://www.isda.org/2020/05/11/benchmark-reform-and-transition-from-libor/ (especially items under the section called "Final IBOR Fallbacks Documentation"). On October 23, 2020, the adherence period for the amended definitions began, and they are scheduled to come into effect on January 25, 2021.

[12] Judgment of the Supreme Court, 1st petty bench, July 19, 1976 (Minshu, No. 118, page 291).

permanent discontinuance of LIBOR, the borrower would bear an obligation to return the borrowed principal and the like to the lender due to unjust enrichment, and it could not at all be thought that the parties to the contract would have intended that.

(2) Approach to applied interest rates

Even if the effectiveness of a contract itself is maintained, if the interest rate cannot be specified, then, normally, it will be difficult to specify whether an obligation will arise to pay an interest rate of a specific amount. Even if that is so, it is thought that this will not be interpreted to mean that an interest rate will not arise. It is clear that the party had the intention of paying some kind of interest rate in the transaction, so it is conceivable that, from the outset, there was an agreement to calculate the interest rate based on LIBOR.

On the other hand, normally, rather than paying attention to LIBOR (i.e., the interest rate benchmark itself) and agreeing, based on LIBOR, to calculating the interest rate, LIBOR was widely accepted as a reference interest rate benchmark that appropriately reflects actual market interest rates when calculating floating rates, so, with that background, it is considered that contractual parties intended for interest to be transferred that corresponds with market conditions based on such a benchmark. Therefore, if alternative interest rate benchmarks to LIBOR converge into one and spread adjustment methodologies converge into one, calculating the interest rate based on that benchmark will be in line with the parties' reasonable intent. By the point in time at which LIBOR is permanently discontinued, the likelihood is high that alternative interest rate benchmarks will not be converge to one benchmark. But, in the Second Public Consultation Document, a specific waterfall structure for fallback interest rates for each instrument is recommended, and if that structure can gain market participants' support and be popularized to a degree whereby it is considered a market convention or an accepted transactional convention, then, even in a contract that has not introduced a fallback provision, following that waterfall structure will be considered as being in line with the reasonable intent of the parties[13].

Viewed from another angle, even if, by the time LIBOR is permanently discontinued, a specific fallback rate or a waterfall structure has not yet become a market convention, the reasonable intent of the parties would be transferring interest that corresponds with market conditions, so that will constitute agreeing in an abstract manner only to paying an interest rate, and it would be inappropriate to apply the statutory interest rate under the Civil Code[14], which is a discretionary provision, and the result of applying the statutory interest rate would clearly be an irrational result. In this case, however, it is very difficult to specify what fallback rate should be adopted in terms of the parties'

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[13] Regarding the waterfall structure recommended by the Second Public Consultation Document, for loans, a certain amount of support for using TIBOR in replacement of O/N RFR compound interest (fixing in arrears) for the 2nd priority has been gained. However, market conventions and accepted transactional conventions will not necessarily be established for only the entire market; and, it should be considered that they might also be established for somewhat limited scopes in the market, such as cases in which the lender is a party with certain attributes.

[14] Article 404 of the Civil Code.

rational intent[15].

To prevent a situation such as that described above, by the time LIBOR is permanently discontinued, it is extremely important for relevant parties to, without fail, introduce fallback provisions to all contracts (or change, in advance, the method used to calculate the interest rate to a method that references an interest rate benchmark as an alternative to LIBOR).

Outside of Japan, there are movements to attempt to solve this point through legislation.

In the United States, the ARRC announced its legislation proposal for New York State law in March 2020[16]. The proposal indicates, amongst other proposals, the following in addition to enforcing, through legislation, use of a recommended benchmark replacement[17] for cases in which a contract has no fallback provision or the fallback provision references LIBOR: (I) prohibiting the refusal of performing contractual obligations and asserting breach of contract for the reason that LIBOR has been discontinued or that a recommended benchmark replacement is to be used; (II) placing the recommended benchmark replacement as a commercially reasonable replacement benchmark for LIBOR and as a benchmark that is commercially substantially equivalent to LIBOR; and (III) providing a safe harbor from litigation in cases in which a recommended alternate benchmark is used.

Moreover, in the U.K., in June 2020, the U.K. Government and the Financial Conduct Authority (FCA) published a statement on legislation pertaining to approaches to transitioning away from LIBOR[18]. The statement states that, before LIBOR is permanently discontinued, sufficient authority will be granted to the FCA in order for it to manage and direct an orderly wind-down of LIBOR such that consumers are protected and market integrity is ensured. Specifically, the statement expresses that legislation is being brought forward that plans to, for example, in the case that LIBOR is no longer representative and its representativeness is difficult to restore, (I) order the administrator of LIBOR to amend the method used to calculate LIBOR and (II) grant the FCA authority to prohibit use of LIBOR, excluding cases in which existing

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[15] Even if the waterfall structure recommended by the Second Public Consultation Document does shape market conventions, for bonds, for example, the Second Public Consultation Document recommends a structure for straight bonds; and for the fallback rate for structured bond referencing LIBOR, it is anticipated that there might be a situation in which there is no market convention.

[16] See the following for an overview of the proposed legislation:
https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Press_Release_Proposed_Legislative_Solution.pdf
See the following for details thereof:
https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Proposed-Legislative-Solution.pdf

[17] This refers to a benchmark replacement to be recommended in legislation, and it is thought that this will be a benchmark based on SOFR.

[18] See the following for the U.K. Government's statement:
https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2020-06-23/HCWS307/
See the following for the FCA's statement: https://www.fca.org.uk/news/statements/fca-statement-planned-amendments-benchmarks-regulation

contracts (i.e., legacy contracts) continue to be used in a restricted manner.

In addition, in the EU, in July 2020, the European Commission made a proposal to amend the EU Benchmarks Regulation[19]. This amendment proposal includes the proposal, amongst others, of the European Commission granting authority to designate an appropriate alternative interest rate benchmark for LIBOR by taking into account recommendations made by relevant industries' working groups (e.g., ARRC) in cases in which that is necessary to prevent disorder in the EU's financial markets when LIBOR is permanently discontinued.

What kind of legislation will specifically be made as a result of these movements is not necessarily clear at the current point in time. In Japan, however, it appears that no movements aiming to find a legislative solution currently exist.

2. Relationship between value transfer and providing loss compensation and special benefits under the Financial Instruments and Exchange Act

(1) Location of problems

For financial instruments business operators, etc.[20], with respect to the purchase and sale of securities, other transactions concerning securities, and derivative transactions, it is prohibited to compensate for any loss incurred by a client, guarantee or add profits to a client, or promise any of those to a client (Prohibition of Compensation of Loss, etc.)[21]; and, moreover, with respect to financial instruments transaction contracts, it is prohibited to provide any special benefit to a client and it is prohibited to promise that (prohibition of providing any special benefit)[22].

In cases in which a fallback provision is introduced and a reference interest rate has been amended, at the point in time when the reference interest rate is amended, a value transfer occurs in which one party makes a gain and the other party incurs a loss. Even if an appropriate spread adjustment is included in a fallback provision, value transfer cannot be entirely eliminated, and there is a likelihood that a value transfer to the client from financial instruments business operators, etc., will arise. Therefore, particularly in relation to derivative transactions, the problem will arise of whether amending a reference interest rate will breach the prohibition of loss compensation, etc., or the prohibition of providing any special benefits.

(2) Deliberation: Prohibiting loss compensation, etc.

Reasons for why loss compensation, etc., is prohibited include that such an act would distort the market's capacity to form fair prices and it would impair the neutrality and integrity of market intermediaries (i.e., financial instruments business operators, etc.).

Amending a reference interest rate due to the permanent discontinuance of LIBOR is

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[19] https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1376

[20] "Financial instruments business operators, etc." refers to financial instruments business operators and registered financial institutions. This is defined in Article 34 of the Financial Instruments and Exchange Act ("**FIEA**").

[21] Article 39(1) of the FIEA.

[22] Article 38, item (ix) of the FIEA; Article 117(1), item (iii) of the Cabinet Office Order on Financial Instruments Business, etc.

an approach for handling circumstances in which the interest rate can no longer be calculated unless it is amended; and not amending the interest rate is an option that is not available. Therefore, it should be understood that even if there is an objective value transfer to a client, as long as the method used to calculate the amended interest rate references a reasonable alternative interest rate benchmark and follows a spread adjustment that uses a reasonable methodology, and fallback provisions that have uniform conditions are applicable for clients in similar circumstances, then loss compensation, etc. will not apply.

In terms of a legal interpretation, in order for loss compensation, etc., to be established, the purpose requirement "to compensate for loss", "to supplement profit", or "to add profit" must be fulfilled, but a reasonable reference interest rate amendment, such as that above, will not fulfil any of the purpose requirements, it is thought.

It is, however, considered that these purpose requirements can be fulfilled even if they co-exist with another purpose (e.g., the purpose of handling the permanent discontinuance of LIBOR). For a purpose requirement to be considered not fulfilled even when co-existing with another purpose, as described above, applying fallback provisions for uniform conditions will be required for clients in similar circumstances. Naturally, it is anticipated that conditions will vary between clients as a result of negotiating with clients, and it is not the case that such handling will absolutely not be permitted. In this case, however, being able to explain that those clients are not in similar circumstances will be required. Therefore, for financial instruments business operators, etc., if a client is handled in a different manner to another client, then that financial instruments business operator, etc., should be prepared to rationally explain the difference in the clients' circumstances by describing, in advance, the reason for the different handling and the rationale behind the specific difference thereof; and, normally, purpose requirement fulfillment is recognized by collecting objective facts over time, so it is important to record and save those facts in the course of negotiations.

(3) Deliberation: Prohibiting provision of special benefits

For prohibiting special benefits provision, acts are regulated to a wider scope than for prohibiting loss compensation, etc. What falls under a "special benefit" is not necessarily clear. But the common view is that judgments are made based on requirements such as (I) whether the benefit itself is appropriate and reasonable in terms of socially accepted conventions and (II) whether providing the benefit constitutes equally providing to all clients based on a certain standard or whether it is provided to specific clients.

In terms of amending a reference interest rate by introducing a fallback provision, regarding the requirement above in (I), there is a shared recognition amongst market participants that there is a likelihood that an alternate interest rate that uses an alternative interest rate benchmark and a spread adjustment methodology, such as those indicated in the First Public Consultation Document and in the Second Public Consultation Document, will be adopted, so calculating an alternative interest rate using an alternative interest rate benchmark and a spread adjustment methodology should, basically, be deemed as appropriate and reasonable in terms of socially accepted conventions. Moreover, it is thought that requirement (II) can be cleared by financial instruments business operators, etc., applying uniform fallback provisions to

clients in similar circumstances. But in the case of handling that differs from that used for other clients, akin to cases involving prohibiting loss compensation, etc., it will be required that records are made and kept in the course of negotiations and that reasons for the different handling and specific differences are kept within an appropriate and reasonable scope in terms of socially accepted conventions.

3. Procedures under the Companies Act related to introducing fallback provisions to corporate bonds

As described above in II.2.(2), to introduce a fallback provision to a bond, in principle, it is necessary to hold a bondholders meeting, pass a resolution for the amendment, and receive approval from a court, in accordance with the provisions of the Companies Act[23]. These procedures include, for example, holding an in-person bondholders meeting (i.e., written resolutions are not permitted) for each series of corporate bonds and the involvement of a court, so the burden of the administrative work is anticipated to be heavy. In the below section, whether it is necessary to obtain a resolution at a bondholders meeting when introducing a fallback provision, resolution requirements in cases where a resolution at a bondholders meeting is necessary, and procedures needed in cases in which all corporate bondholders have provided consent are deliberated.

(1) Necessity for resolution at a bondholders meeting and resolution requirements

To amend the content of a contract for corporate bonds, as a general principle, it is necessary to obtain the consent of the issuing company and all corporate bondholders. However, anticipating situations in which obtaining the consent of all corporate bondholders will be difficult, such as cases in which there are a great many corporate bondholders, for items set forth in the provisions of the Companies Act and the Secured Bonds Trust Act (i.e., statutory resolution items)[24] and items related to interests of corporate bondholders (i.e., voluntary resolution items), an amendment can be made by a resolution at a bondholders meeting[25].

It is clear that introducing a fallback provision constitutes an amendment to an interest rate or to the method used to determine one and that it is an item that is related to the interests of corporate bondholders. Therefore, presuming that the fallback provision introduction is to be carried out with the intention of maintaining a substantially equivalent interest rate level after LIBOR is discontinued, amending a corporate bonds contract in order to introduce a fallback provision does not constitute a statutory resolution item, and a resolution would be passed for it by treating it as a voluntary resolution item. Regarding resolution requirements in that case, it does not constitute

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[23] A court cannot approve a resolution at a bondholders meeting “If the resolution is contrary to the general interests of bondholders.” (Article 733, item (iv) of the Companies Act). However, introducing fallback provisions to prepare for the permanent discontinuance of LIBOR will not, generally, constitute a “resolution that is contrary to the general interests of bondholders”, as long as the content thereof is content that market participants anticipated.

[24] Examples of statutory resolution items include those under Article 706 of the Companies Act and Article 35 of the Secured Bonds Trust Act.

[25] Article 716 of the Companies Act.

an item set forth in the Companies Act or the Secured Bonds Trust Act[26] as a special resolution item, so, as an ordinary resolution item, it would be necessary to obtain the consent of a majority of the total amount of voting rights of voting right holders in attendance[27].

(2) Handling cases in which all corporate bondholders consent

As described above in (1), introducing a fallback provision to a contract related to corporate bonds falls under a voluntary resolution item at a bondholders meeting. However, a resolution at a bondholders meeting does not come into effect unless a court's approval is obtained[28], and it is anticipated that a corresponding time cost and monetary cost will arise in order to obtain a court's approval. Therefore, in cases in which all corporate bondholders consent, whether it will be possible to omit obtaining a resolution at a bondholders meeting and a court's approval will be an issue for discussion.

In the current Companies Act, there are no explicit provisions regarding this point. But, for voluntary resolution items, it should be understood that contractual content related to corporate bonds is amendable with the consent of all corporate bondholders, without requiring a resolution at a bondholders meeting or a court's approval[29]. Therefore, in cases in which the number of corporate bondholders is limited, as is the case with privately placed bonds, first, aiming to introduce a fallback provision with the consent of all corporate bondholders should be taken into account.

4. Explaining the content of fallback provisions to clients

After the permanent discontinuance of LIBOR, in addition to the high likelihood that alternative interest rate benchmarks to LIBOR will not converge to one benchmark, the risk of value transfer cannot be completely eliminated, irrespective of how a replacement interest rate is determined

It is anticipated that differing degrees of value transfer will arise depending on the kind of conditions under which fallback provisions are introduced. Therefore, even if fallback provisions are amicably introduced, there is a likelihood of disputes subsequently arising between parties. This risk is considered to be reduceable only if the parties sufficiently understand the content of fallback provisions and their meaning.

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[26] Article 724(2) and Article 736(1) of the Companies Act; Article 32 of the Secured Bonds Trust Act; etc.

[27] Article 724(1) of the Companies Act.

[28] Article 734(1) of the Companies Act.

[29] Regarding Article 735-2 of the Amendment Act of the Companies Act established on December 3, 2019 (to go into effect within 18 months of December 11, 2019, which is the promulgation date; the "**Amended Companies Act**"), when all corporate bondholders have consented to a proposal, it is "deemed that a resolution was passed at a bondholders meeting" with respect to the proposal, and, moreover, there is a provision that explicitly states a court's approval is not required (Article 735-2(4) of the Amended Companies Act). Treating these provisions as foundational provisions, under existing laws, the doubt might exist that, even if all corporate bondholders provide consent, it still might not be possible to omit passing a resolution at a bondholders meeting. But in light of past theories, for voluntary resolution items at least, the provisions of the Amended Companies Act should be considered as provisions that set forth an interpretation of existing laws.

Negotiations related to introducing fallback provisions are normally led by financial institutions that provide relevant instruments. But, when financial institutions carry out negotiations related to fallback provisions, from the perspective of preventing subsequent disputes, it is necessary for the financial institutions to provide sufficient explanations to their clients, who are the users[30].

IV. Conclusions

Of the approaches for handling the permanent discontinuance of LIBOR, this document has mainly focused upon those related to amending relevant contracts. But approaches for handling the permanent discontinuance of LIBOR are not limited to these. For example, to introduce fallback provisions, it is necessary to specify loans, bonds, and the like for which relevant arrangements are required and negotiate with counterparties, and, in addition to requiring allowances for personnel and in-house training for that end, it is also necessary to deliberate on improving[31] the robustness of the term RFR, which is placed as a candidate for LIBOR's alternative interest rate benchmark and 1st priority in the recommend waterfall in the Second Public Consultation Document; system modification; and accounting issues and challenges[32].

In relation to this point, the Financial Services Agency and the Bank of Japan issued a letter called "Taking Actions for Permanent Cessation of LIBOR" to CEOs of major financial institutions on June 1, 2020, (i.e., the so-called "Dear CEO letter") and thereby requested quick action to be taken[33]. Moreover, based on developments outside of Japan and market participants' requests, the Cross-Industry Committee has formulated a transition plan that stipulates a timeframe and other information for handling the transition, and it included the plan in its Second Public Consultation Document[34]. This transition plan includes information about publishing the amended ISDA definitions and protocol, releasing a draft on hedge accounting, publishing the production rate of term RFRs, and the timeframe for arranging an infrastructure (i.e., modifying the book-entry transfer system for corporate

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[30] Provisions under the Banking Act, the Money Lending Business Act, and other laws impose an obligation to provide an explanation, and there are cases in which an explanation is provided by delivering a document. Moreover, the First Final Report states the following: "For loans, as different views were presented by lenders and borrowers, it was confirmed that they would need to reach a mutual agreement on the path for permanent measures, which includes the selection of the temporary options described above, by engaging in sufficient communication with each other." (page 17 of the First Final Report).

[31] For details of specific initiatives, see from page 11 of the Second Public Consultation Document.

[32] Specifically, in cases in which there will be an interest rate benchmark for which the fallback rate differs between hedged items and hedging instruments, whether hedge accounting can continue to be applied will be a problem. For details, see page 28 of the First Public Consultation Document. In relation to this point, the Accounting Standards Board of Japan published the following on September 29, 2020: Treatment of Hedge Accounting for Financial Instruments that Reference LIBOR (https://www.asb.or.jp/en/jp-gaap/accounting_standards/y2020/2020-0929.html, https://www.asb.or.jp/jp/accounting_standards/practical_solution/y2020/2020-0929.html [report available only in the Japanese language]).

[33] https://www.fsa.go.jp/policy/libor/dearceoletter20200601.pdf (available only in the Japanese language)

[34] Figure 2-8 of the Second Public Consultation Document.

bonds); and each company must set its own timeframe for each item requiring action. In the future, it is likely that not also financial institutions providing financial instruments referencing LIBOR but also users, such as non-financial corporates, will be required to urgently make arrangements that are in accordance with the above transition plan.