

Compliance with “IOSCO Principles for Financial Benchmarks (19 principles)”

July 7, 2014

*Ippan Shadan Hojin* JBA TIBOR Administration

- ◇ The “Final Report on Principles for Financial Benchmarks (IOSCO Principles)”<sup>1</sup> published by the International Organization of Securities Commissions (“IOSCO”) (on July 17, 2013) sets out that Benchmark Administrators should publically disclose the extent of their compliance with the IOSCO Principles within 12 months from the publication of the Final Report. Accordingly, the JBA TIBOR Administration (“JBATA”; See Reference 1) conducted a self-assessment with regard to the “JBA TIBOR (Tokyo Interbank Offered Rate)” calculated and published by JBATA, designating July 4, 2014 as a base date of this self-assessment. Today, JBATA is pleased to announce the self-assessment results.
  
- ◇ The summary of the self-assessment results is as described below (for details, see Reference 2).
  - Since the publication of the IOSCO Principles about a year ago, JBATA has been committed to implement its initiative to comply with the Principles, and considers that it has largely achieved the compliance.
  
  - Future tasks include establishment of processes and frameworks for collection of inter-bank transactional data in the unsecured call market and further carrying out data analysis.
  
- ◇ At the same time, IOSCO is currently reviewing JBATA’s compliance with the IOSCO Principles, at the request of the Financial Stability Board (“FSB”). However, a base date of such review is prior to that of this self-assessment. Therefore, please note that the results of this IOSCO’s review do not reflect recent implementation and remediation made by JBATA and thus may differ from the results of our self-assessment.
  
- ◇ JBATA, in consideration of international discussions at the FSB and other bodies, will seek to maintain and enhance the credibility and transparency of JBA TIBOR and will be committed to strengthen the administration of JBA TIBOR, through establishing and maintaining a framework in accordance with the IOSCO Principles, so that JBA TIBOR will be recognized internationally as a benchmark conforming to the IOSCO Principles and will continue to be used widely as a representative benchmark for the Japanese yen interest rate.

(Reference 1) About the JBA TIBOR Administration

- ◇ On April 1, 2014, JBATA was formed to establish a more independent and neutral administration framework for the JBA TIBOR. The "JBA TIBOR" calculation and publication operations were transferred from the *Ippan Shadan Hojin* Japanese Bankers Association on the same day.

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<sup>1</sup> A report (<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>) released by IOSCO on July 17, 2013, which provides an overarching framework of Principles for Benchmarks used in financial markets and sets out 19 principles.

- ◇ JBATA requires reference banks that submit rates to comply with the Code of Conduct, which sets out rules to be abided by and necessary procedures to be established by reference banks in connection with their rate submission, as well as monitors reference banks' compliance with the Code of Conduct and rate submissions.

(With regard to the background relating to the establishment of JBATA, please see "Report on the Review of JBA TIBOR Administration"<sup>2</sup> released by the Japanese Bankers Association on December 27, 2013.)

#### (Reference 2) Compliance with the IOSCO Principles

- ◇ Governance

- Principle 1 Overall Responsibility of the Administrator

- JBATA assumes overall responsibility for the JBA TIBOR administration, including the definition of the Benchmark, processes for determining Benchmark and its governance arrangements. In addition, such processes and arrangements are documented in the JBA TIBOR Operational Rules ("Operational Rules") and the JBA TIBOR Code of Conduct ("Code of Conduct") and are released on the JBATA's website. These demonstrate our compliance with the IOSCO Principles.

- Principle 2 Oversight of Third Parties

- The following third parties are related to the calculation and publication of the JBA TIBOR. The Operational Rules, the Code of Conduct and the Guidelines on Outsourcing JBA TIBOR Calculation/Publication Operations ("Outsourcing Guidelines") stipulate policies and procedures for JBATA's management or supervision of third parties and the following steps have been taken, which indicates that JBATA is broadly compliant with the IOSCO Principles. With a view to strengthening the governance over the JBA TIBOR calculation and publication processes, monitoring of the service provider, the Japanese Bankers Association and the Osaka Bankers Association, is planned to be carried out within the fiscal year ending March 31, 2015.

- ✓ Reference banks

- References banks are supervised in accordance with the Code of Conduct and reference banks' compliance with the Code of Conduct is reviewed annually and whenever the Code of Conduct is amended. In this fiscal year, a review of all of the reference banks' internal rules has been completed. The result indicates that appropriate processes and frameworks compliant with the Code of Conduct are in place.

- ✓ Service provider (currently, QUICK Corp.)

- Policies and procedures for the management or monitoring of the operations outsourced to the service provider are set out in the Operational Rules, the Outsourcing Guidelines and the Outsourcing Agreement.

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<sup>2</sup> <http://www.zenginkyo.or.jp/news/2013/12/27103000.html>

✓ Japanese Bankers Association

The operations outsourced to the Japanese Bankers Association are provided in the Operational Rules, the Outsourcing Guidelines and the Agreement on Outsourced Operations.

✓ Osaka Bankers Association

The operations outsourced to the Osaka Bankers Association are provided in the Operational Rules, the Outsourcing Guidelines and the Agreement on Outsourced Operations.

➤ Principle 3 Conflicts of Interest for Administrators

JBATA has in place the Operational Rules setting forth conflicts of interest that may arise in the course of the JBA TIBOR administration, including the involvement in the process of definition and determination of the JBA TIBOR by the person belonging to a financial institution. Based on this, JBATA stipulates measures to manage and mitigate such conflicts of interest in its Operational Rules, and implement these measures. Accordingly, JBATA is broadly compliant with the IOSCO Principles.

Furthermore, statements of whether the Board members and the Oversight Committee members have conflicts of interest were released on the JBATA's website on July 4, 2014, disclosing information on conflicts of interest to users and related authorities.

JBATA aims to establish procedures and frameworks to manage information-sharing appropriately between persons involved in activities at JBATA that may pose a risk of conflicts of interest.

➤ Principle 4 Control Framework for Administrators

JBATA has in place the governance framework which mainly focuses on ensuring the integrity and transparency of the Benchmark administration to assume the responsibility for the integrity of the calculation and publication of the JBA TIBOR. This substantiates that JBATA is broadly compliant with the IOSCO Principles.

The Board of Directors is formed as a decision-making body of JBATA. The JBA TIBOR Oversight Committee ("Oversight Committee"), which is comprised of external experts, is set up under the Board of Directors. The Oversight Committee has a high degree of independence, and assesses the appropriateness of the JBA TIBOR administration and provides the Board of Directors with recommendation of remedial measures.

A provision of the Operational Rules is established which stipulates that the majority of the Board members of JBATA shall consist of the persons other than those who are working for or belonging to financial institutions, and has been implemented. In addition, the provision also sets forth that the Oversight Committee shall be comprised of experts (e.g. lawyers, CPAs, academic experts), and from the perspective of maintaining independence, those who belong to banks should not be

appointed as a member. This has also been implemented.

The above control framework is stipulated in the Operational Rules, which is disclosed on the JBATA's website. The necessity of additional remedial measures if any will be considered.

➤ Principle 5 Internal Oversight

The JBATA's Operational Rules provides that the Oversight Committee comprised exclusively of external members shall carry out assessment of the appropriateness of the JBATA TIBOR administration framework and provide recommendation of remedial measures to the Board of Directors. This demonstrates our compliance with the IOSCO Principles.

Specifically, the Oversight Committee carries out assessment of the appropriateness for the management of conflicts of interest, responses to findings, complaints and other suggestions by external parties, the monitoring of reference banks' compliance with the Code of Conduct and rate submissions as well as amendments to the rules and regulations, such as the Code of Conduct, and an internal audit plan.

◇ Quality of the Benchmark

➤ Principle 6 Benchmark Design

“Underlying interest” which JBA TIBOR seeks to measure is the “rate which reference banks deem as prevailing market rates, assuming transactions between prime banks on the Japan unsecured call market (the Japan Offshore Market in case of the Euroyen TIBOR) as of 11:00 a.m.”, and JBA TIBOR is calculated as the simple average of interest rates submitted by reference banks which excludes two highest quotes and two lowest quotes from reference banks.

The Code of Conduct sets out rules to be complied by reference banks and necessary processes to be established for the purpose of ensuring appropriate rate submission by reference banks based on the definition. In addition, the Code of Conduct requires reference banks to have external audit and internal audit annually as well as to report their results to JBATA with an aim to ensure reference banks' compliance with the Code of Conduct.

In addition, for the purpose of ensuring appropriate rate submission by reference banks based on a more thorough definition, the Code of Conduct was amended effective July 4, 2014 and newly stipulates “each reference bank shall take into account transactions between prime banks on the Japan unsecured call market (Euroyen transactions in the Japan Offshore Market in case of Euroyen TIBOR) as a minimum requirement and take precedence as an input into the calculation of reference rates subject to the definition of JBA TIBOR if the transactions are observable”. The revision will be applied from October 6, 2014.

The steps stated above enable the JBA TIBOR to reflect the “rates which reference banks deem as prevailing market rates, assuming transactions between prime banks on the Japan unsecured call market (the Japan Offshore Market in case of the Euroyen TIBOR) as of 11:00 a.m.”

According to the statistics published by the Bank of Japan (“BOJ”), the unsecured call market has the outstanding balance of 5,834.7 billion yen (as of May 30, 2014) and is considered to be generally active.

In order to periodically assess whether JBA TIBOR appropriately reflects “underlying interest” which it seeks to measure, JBATA will consider establishing processes and frameworks for the collection of data of transactions between banks in the unsecured call market (Euroyen transactions in case of Euroyen TIBOR) based on discussions with relevant bodies, including the Financial Services Agency of Japan (“FSA”) and the BOJ, and carrying out post-assessment of JBA TIBOR using the data collected.

➤ Principle 7 Data Sufficiency

With regard to JBA TIBOR, the Code of Conduct was amended on July 4, 2014 which sets out that the determination of rates to be submitted by reference banks shall be the rate consistent with the JBA TIBOR definition, and that each reference bank shall take into account transactions between prime banks on the Japan unsecured call market (Euroyen transactions in the Japan Offshore Market in case of Euroyen TIBOR) as a minimum requirement and take precedence as an input into the calculation of reference rates subject to the definition of JBA TIBOR if the transactions are observable. Each reference banks shall submit rates in line with this Code of Conduct, taking into account data on unsecured call transactions (“Euroyen transactions” in case of Euroyen TIBOR) preferentially.

Rate submissions are not necessarily been based only on the actual transaction data. This treatment is to enable reference banks to refer to other types of related transactional data and other qualitative information (e.g., indicative prices) and to supplement sufficient observable market data with expert judgment, in cases where sufficient observable data of unsecured call transactions is not available for some tenors to be reflected in rate submission by reference banks due to certain market environment.

The IOSCO Principles also permits that certain administrators may decide to rely upon expert judgment in an active albeit low liquidity market, when transactions may not be consistently available each day.

JBATA will consider establishing processes and frameworks for the collection of inter-bank unsecured call transaction data (Euroyen transactions in case of Euroyen TIBOR), based on dialogues with relevant bodies, including the FSA and BOJ to monitor rate submissions by reference banks as well as to share its results with IOSCO and related authorities.

➤ Principle 8 Hierarchy of Data Inputs

JBATA has in place the Code of Conduct stipulating that in order to submit the rates based on to the definition, reference banks shall set standards for the types and scope of transactions, qualitative information and other reference information used in

determining reference rates, by specifically defining the types and scope of transactions and other information which are of higher priority over other inputs into the calculation of a reference rate.

In addition, for the purpose of ensuring appropriate rate submission by reference banks based on a more thorough definition, the Code of Conduct was amended effective July 4, 2014 and newly stipulates “each reference bank shall take into account transactions between prime banks on the Japan unsecured call market (Euroyen transactions in the Japan Offshore Market in case of Euroyen TIBOR) as a minimum requirement and take precedence as an input into the calculation of reference rates subject to the definition of JBA TIBOR if the transactions are observable.”. The revision will be applied from October 6, 2014.

Reference banks will submit rates that preferentially reflect unsecured call transactions in line with the Code of Conduct. This measure demonstrates our compliance with the IOSCO Principles.

➤ Principle 9 Transparency of Benchmark Determinations

JBATA stipulates the calculation and publication processes in the “(Attachment 1) Rate Submission Procedures” of the Code of Conduct and releases the information on its website.

Rates submitted by reference banks are the sole data sources used in the JBA TIBOR determination process and published simultaneously through the service provider. The JBA TIBOR and the rates submitted by reference banks, including the two highest quotes and the two lowest quotes excluded from the calculation of the JBA TIBOR, are available by users and related authorities. The calculation methods are also set forth in the Code of Conduct and are disclosed on the website.

JBATA will consider establishing processes and frameworks for collecting data on inter-bank unsecured call transactions (“Euroyen transactions” in case of Euroyen TIBOR) from reference banks, and publishing a summary of unsecured call transactions executed by all reference banks, based on discussions with relevant authorities including FSA and BOJ.

➤ Principle 10 Periodic Review

The Operational Rules stipulate assessment and review of the definition of JBA TIBOR, and the calculation methods in consideration of market conditions which JBA TIBOR seeks to reflect, as well as feedbacks and complaints received from external parties to JBATA.

The Code of Conduct and the Operational Rules are subject to periodic review. The former was amended on July 4, 2014 (effective on October 6, 2014) and the latter will be revised within the fiscal year ending March 31, 2015. Related rules and guidelines will be modified in line with the processes set forth in the Operational Rules. These indicate that JBATA is broadly compliant with the IOSCO Principle.

Taking account of the usage of JBA TIBOR, 13 different tenors (1 week and 1-12

months) currently being published will be reduced. Specifically, the publication of TIBOR for seven tenors (i.e. 4 months, 5 months, 7 months, 8 months, 9 months, 10 months and 11 months) will be discontinued on April 1, 2015, and six tenors (i.e. 1 week, 1 month, 2 months, 3 months, 6 months and 12 months) will continue to be published onwards. This change is already disclosed on our website.

◇ Quality of the Methodology

➤ Principle 11 Content of the Methodology

JBATA documents the calculation methods in the Code of Conduct and the Operational Rules and publishes the information on its website. Further, the policies on adopting such calculation methods are contained in the “Report on the Review of JBA TIBOR Administration” published in December 2013 by the *Ippan Shadan Hojin* Japanese Bankers Association, which was the then administrator. This demonstrates JBATA is broadly compliant with the IOSCO Principle.

In order to enhance the quality of the calculation methods, the following three measures will be implemented:

(1) Minimum data criteria

The Code of Conduct amended on July 4, 2014 stipulates that where unsecured call transactions (“Euroyen transactions” in case of Euroyen TIBOR) between prime banks are observable, reference banks must take such transactions into consideration. This will be applied from October 6, 2014.

(2) Criteria for use of expert judgment

The Code of Conduct amended on July 4, 2014 specifies criteria for use of expert judgment, which will be applied from October 6, 2014.

(3) Application for reference bank by overseas financial institution and its selection

The Operational Rules plans to be revised within this fiscal year ending March 31, 2015, stipulating that when the applying bank is located in a jurisdiction outside of Japan, any issues which may arise from its location should be considered in the selection process.

➤ Principle 12 Changes to the Methodology

JBATA has in place the Operational Rules setting out procedures for changes in the definitions or calculation methods of the JBA TIBOR, including criteria for carrying out public consultation, the required notification period for such changes on its website (three months prior to the effective date), and the decision making process (such changes shall be decided by the Board of Directors after discussion at the Administration Committee and confirmation by the Oversight Committee). The amendment dated July 4, 2014 to the Code of Conduct, which will be applied from October 6, 2014, was also made in accordance with these procedures. Accordingly, JBATA is in compliance with the IOSCO Principles.

➤ Principle 13 Transition

JBATA has in place the Operational Rules stipulating processes for cessation of the JBA TIBOR, which demonstrates that JBATA is broadly compliant with the IOSCO

## Principles.

In addition, JBATA recommends on its website updated 1 April 2013, users of JBA TIBOR to agree on a "fall-back" provision as an alternative arrangement or measure to prepare for the situations where the JBA TIBOR has not been published.

- **Principle 14 Submitter Code of Conduct**  
JBATA has in place the Code of Conduct setting out issues to be complied with and necessary procedures to be established by reference banks in connection with their rate submission. JBATA received from reference banks their internal rules which are based on the Code of Conduct, completed a detailed review of these internal rules, and reported the results to the Oversight Committee. This substantiates our compliance with the IOSCO Principles.
- **Principle 15 Internal Controls over Data Collection**  
Currently, only rates submitted by reference banks are used to calculate JBA TIBOR and JBATA does not collect data from external parties. Accordingly, this Principle is determined to be not applicable to our assessment.
- ✧ **Accountability**
  - **Principle 16 Complaints procedures**  
The JBATA's Operational Rules set out management of complaints from users or other beneficiaries, in relation to the JBA TIBOR determination. Feedback and complaints in relation to JBA TIBOR are reported to the Oversight Committee and the appropriateness of its management is assessed. Accordingly, JBATA is in compliance with the IOSCO Principles.
  - **Principle 17 Audits**  
JBATA has appointed internal and external auditors and established a framework for internal and external audits. JBATA will be subject to annual audits set forth in the Operational Rules. Accordingly, JBATA is broadly compliant with the IOSCO Principles.
  - **Principle 18 Audit Trail**  
The JBATA's Operational Rules and the Code of Conducts stipulate the retention of the records required by the IOSCO Principles for five years. Accordingly, JBATA is in compliance with the IOSCO Principles.
  - **Principle 19 Cooperation with Regulatory Authorities**  
The JBATA's Operational Rules set forth that authorities by submitting the JBATA shall cooperate with relevant regulatory authorities by submitting and reporting records and audit results regarding the JBA TIBOR calculation and other relevant information immediately upon their request. Accordingly, JBATA is in compliance with the IOSCO Principles.