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For Immediate Release

ISDA Publishes Two Consultations on Benchmark Fallbacks

NEW YORK, May 16, 2019 – The International Swaps and Derivatives Association, Inc. (ISDA) has launched two new consultations on benchmark fallbacks – one covering adjustments that would apply to fallback rates in the event certain interbank offered rates (IBORs) are permanently discontinued, and another relating to pre-cessation issues for LIBOR and certain other IBORs.

The first consultation sets out options for adjustments that will apply to the relevant risk-free rates (RFRs) if fallbacks are triggered for derivatives referencing US dollar LIBOR, Hong Kong's HIBOR and Canada's CDOR. Feedback is also sought on a proposed fallback for Singapore's SOR following a permanent cessation of US dollar LIBOR, given US dollar LIBOR is currently used as an input to calculate the Singapore rate.

These adjustments reflect the fact that the IBORs are currently available in multiple tenors – for example, one, three, six and 12 months – but the RFRs identified as fallbacks are overnight rates. The IBORs also incorporate a bank credit risk premium and a variety of other factors (such as liquidity and fluctuations in supply and demand), while RFRs do not.

The new publication follows a previous consultation last year that covered sterling LIBOR, Swiss franc LIBOR, yen LIBOR, yen TIBOR, euroyen TIBOR and the Australian Bank Bill Swap Rate (BBSW).

The results of that consultation found that the overwhelming majority of respondents preferred the 'compounded setting in arrears rate' to address the difference in tenors, and a significant majority across different types of market participant preferred the 'historical mean/median approach' to address the difference in risk premia. ISDA expects to use the results of the two consultations to implement fallbacks for the relevant IBORs by the end of this year.

"It is vital that derivatives contracts have robust fallbacks in place to mitigate the systemic impact of a key IBOR ceasing to exist. Given the differences between the IBORs and the relevant RFRs identified as fallbacks, it is also imperative that the market agrees a common approach to adjusting the RFRs to mitigate potential disruption after a fallback takes effect," said Scott O'Malia, ISDA's Chief Executive.

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The other consultation relates to pre-cessation issues, and seeks comment on how derivatives contracts should address a regulatory announcement that LIBOR or certain other IBORs categorized as critical benchmarks under the EU Benchmarks Regulation[1] are no longer representative of an underlying market.

Anything implemented as a result of this consultation would be in addition to the fallbacks ISDA expects to implement to address a permanent cessation of a key IBOR. This consultation follows a request by the Financial Stability Board's Official Sector Steering Group (FSB OSSG) for ISDA to request comment on the events that should trigger a move to a spread-adjusted fallback rate for LIBOR.

"It's important to get market feedback on issues arising from a determination that LIBOR is no longer representative, in order to inform whether and how ISDA should address such an event in industry standard documentation for derivatives," said Mr. O'Malia.

Both consultations are open until July 12, 2019.

The supplemental consultation on spread and term adjustments for fallbacks in derivatives referencing US dollar LIBOR, CDOR and HIBOR and certain aspects of fallbacks for derivatives referencing SOR is available here.

The consultation on pre-cessation issues for LIBOR and certain other IBORs is available here.

Background

- In July 2016, the FSB OSSG asked ISDA to participate in work to enhance the robustness of derivatives contracts referencing widely used benchmarks. The FSB's objectives were for market participants to understand the fallback arrangements that would apply if key IBORs were permanently discontinued, and for the arrangements to be robust enough to prevent potential serious market disruption.
- If an IBOR is not available (including if it is permanently discontinued), current fallbacks under the 2006 ISDA Definitions require the calculation agent to obtain quotes from major dealers in the relevant interdealer market. If an IBOR has been permanently discontinued, it is likely that major dealers would be unwilling and/or unable to give such quotes. Even if quotes were available in the near-term after a permanent discontinuation, it is unlikely they would be available for each future reset date over the remaining tenor of long-dated contracts. It is also likely that quotes could vary materially across the market.

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[1] The consultation on pre-cessation issues does not cover yen TIBOR, euroyen TIBOR, BBSW, HIBOR or CDOR. The consultation covers SOR only insofar as to consider if the SOR fallback for a US dollar LIBOR index cessation event – which is separately being consulted upon currently – should also apply in the event of a US dollar LIBOR pre-cessation trigger

- Following consultation with the industry, regulators and the FSB OSSG, it was determined that the fallbacks will be the RFRs identified by the relevant public-/private-sector working groups as an alternative to the IBORs.
- These public-/private-sector working groups are now working to encourage transition from the IBORs to the identified RFRs. Working groups have been set up in several jurisdictions, including Europe (the Working Group on Euro Risk-Free Rates), Hong Kong (the Working Group on Alternative Reference Rates), Japan (the Japanese Study Group on Risk Free Reference Rates), Switzerland (the National Working Group on Swiss Franc Reference Rates), the UK (the Working Group on Sterling Risk-Free Reference Rates) and the US (the Alternative Reference Rates Committee).
- The ISDA fallbacks will be included in the ISDA definitions for interest rate derivatives and will apply to new IBOR trades. ISDA will also publish a protocol to allow participants to include the fallbacks within legacy IBOR contracts, if they choose to.
- Following the first consultation on adjustments for sterling LIBOR, Swiss franc LIBOR, yen LIBOR, yen TIBOR, euroyen TIBOR and the BBSW, ISDA is in the process of developing fallbacks based on the compounded setting in arrears rate approach and the historical mean/median approach for benchmarks covered by that consultation. The developed approach will be published for review and comment before any changes are made to the 2006 ISDA Definitions.

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About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 900 member institutions from 71 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.