ISDA/Bloomberg Benchmark Regulation and Migration Conference, Hong Kong
The Industry Road Map
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So far this morning, we've heard from the official sector, and we've had some important and helpful insights on global developments and the approach being taken in Asia-Pacific.

Thanks again to Ellis Connolly at the Reserve Bank of Australia for sharing his views.

Now, it's time to talk about the various industry initiatives, the progress that's been made, and the roadmap for future industry work.

First, I'd like to take you back a year ago to our inaugural Hong Kong ISDA/Bloomberg benchmark event.

Those of you who were here then would have heard me preview some preliminary results from our global benchmark transition report and survey.

That report revealed a number of important findings. It showed that awareness of benchmark reform was relatively high in some quarters, but low in others – particularly among corporate end users.

It showed a limited understanding or acceptance of the risks posed by a cessation of IBORs by some participants.

And it showed that relatively little action had been taken to prepare for the adoption of risk-free rates – just 11% of respondents had allocated budget and resources to benchmark reform.

Fast forward a year, and a lot has changed.

I'm pleased to report that significant progress has been made in the key areas – adoption of alternative risk-free rates, implementation of robust contractual fallbacks, and addressing requirements under the EU Benchmarks Regulation.

In my remarks this morning, I'll describe the progress made in each of these three areas. But I'll spend most of my time on the implementation of fallbacks for derivatives contracts – the work that's being led by ISDA.

Adoption of Alternative Risk-Free Rates

Those who came to our annual general meeting in Hong Kong last month would have heard me talk about the global challenges facing the derivatives market.

Well, it doesn't get much more global than benchmark reform. With an estimated $370 trillion in notional exposure to the IBORs, this is an issue that affects all users of derivatives, in all sectors, in all jurisdictions.

And time is not on our side. The UK FCA has made clear that it won't compel or persuade panel banks to submit to LIBOR after the end of 2021 – 31 months from now. That might seem like a long time. Given the scale of the exposures, it's really not.

The good news is that progress has been made, led by the various public-/private-sector risk-free rate working groups, including the ARRC in the US.

These groups have focused on outreach and awareness, and knowledge of the issues is now much greater than it was a year ago. In the US and UK, we've seen the emergence of futures products and clearing services for swaps linked to the new risk-free rates, and the first cash bonds linked to SOFR and SONIA have been issued.

In Asia-Pacific, regulators in Australia, Hong Kong, Singapore and elsewhere have worked to review the robustness of existing domestic benchmarks. Even where they have decided to retain existing rates, they have looked to identify robust risk-free rates that can be used as an alternative to domestic interbank benchmarks and are suitable as fallbacks.

As a result of these developments, trading volumes in the risk-free rates are growing. Futures trading volumes have been climbing, and OTC derivatives linked to these rates have been slowly gathering steam.

Based on data reported to US swap data repositories, approximately $22.6 billion in SOFR was traded in the first quarter of 2019.

That's still a small fraction of the roughly $34.8 trillion in traded swaps notional linked to US dollar LIBOR that was reported to US repositories over the same period. But it has to be remembered that SOFR is starting from scratch – it only recently had its first birthday.

Volumes in interest rate swaps linked to SONIA are higher – about $1.7 trillion in the first quarter of 2019, according to data reported to US repositories. That's about half the swaps notional traded on sterling LIBOR and reported to US repositories during the first three months of the year.

So, we're heading in the right direction. But there's still an enormous amount of work ahead of us.

For ISDA's part, we've worked to increase awareness and publish educational materials. We've also looked to ensure the documentation is in place to support trading of the new rates. We've

published definitions for SONIA and SOFR, and will follow with definitions for €STR once it is published in October.

The action plans set out by some public-/private-sector working groups will also likely act as a catalyst to further growth. For instance, clearing houses are expected to move to SOFR price alignment interest and discounting for new and legacy swaps in the second half of 2020 – a move likely to stimulate more liquidity in SOFR.

Ultimately, though, it comes down to everyone getting familiar with the new rates and starting to trade them. Given the uncertainty over LIBOR post-2021, our advice is not to leave this to the last minute. Ensure your firm has the systems and infrastructure in place to use these rates. Start referencing new contracts to the alternative RFRs where appropriate and begin trading them.

Act early and voluntarily move to the alternative rates before a cessation of LIBOR, or before any significant decline in liquidity. You don't want to be the last person standing.

Fallbacks

I'd now like to turn to fallbacks.

To reiterate what I said a moment ago, the best approach is for derivatives market participants to move to the alternative rates on a voluntary basis, before a permanent cessation of LIBOR.

We also recognize we need a safety net that will allow contracts that still reference LIBOR and other IBORs to survive a sudden discontinuation of the underlying benchmark with the minimum possible disruption.

That's why ISDA has played a leading role in an industry effort to implement robust, consistent fallback language for derivatives contracts.

We've been working on this since 2016, when the Financial Stability Board's Official Sector Steering Group asked us to review the robustness of fallback provisions for derivatives referenced to key IBORs. The fallbacks have been identified, and will be the relevant risk-free rates for a given currency – for example, the fallback for US dollar LIBOR will be SOFR.

However, a switch to the relevant risk-free rate following a permanent cessation of an IBOR is not straightforward. That's because IBORs are currently available in multiple tenors, but the risk-free rates are overnight. The IBORs also incorporate a bank credit risk premium and a variety of other factors, while risk-free rates do not.

As a result, we consulted on technical adjustments last year that would apply to the fallback rate in the event an IBOR is permanently discontinued. The aim of the adjustments is to ensure the contracts function as closely as possible to the counterparties' original intentions after a fallback kicks in, resulting in a rate that is predictable, transparent and fair. However, it's important to point out that the adjusted risk-free rate will not match the relevant IBOR exactly – so there will

be winners and losers if a fallback is triggered. That's another reason to begin transition efforts early.

The first consultation covered sterling LIBOR, Swiss franc LIBOR, yen LIBOR, TIBOR, euroyen TIBOR and the Australian Bank Bill Swap Rate.

I'm pleased to report 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 participants preferred the 'historical mean/median approach' to address the difference in risk premia.

Equally importantly, market participants expressed a preference for the same consistent approach to be applied to other IBORs.

That view is now being tested with a supplemental consultation we launched earlier this month on US dollar LIBOR, HIBOR and CDOR. That consultation also seeks feedback on the use of an adjusted SOFR as an input to a fallback for Singapore's SOR if US dollar LIBOR ceases. That's because US dollar LIBOR is used as an input for SOR, so a cessation of US dollar LIBOR would result in a cessation of SOR.

Simultaneously, we launched an additional consultation on pre-cessation issues. This is in response to a request by the FSB OSSG for ISDA to ask for comment on the events that should trigger a move to a fallback rate for LIBOR and certain other IBORs.

It follows remarks from the FCA's director of markets and wholesale policy Edwin Schooling-Latter earlier this year that the regulator may ultimately determine that the number of banks submitting to LIBOR had declined to such an extent that the rate is no longer representative of the market.

The consultation asks market participants for their views on the issues that would emerge following an announcement that LIBOR is no longer representative, and whether and how ISDA documentation should address it.

So, what are the next steps? The comment period for both consultations ends on July 12. I'd encourage each of you to participate and send in responses.

In the meantime, we'll work to further flesh out the parameters and mechanics of the term and spread adjustments. Internal work is already under way to analyze feedback received so far and to perform sensitivity analysis. This will be released for comment sometime after the outstanding consultations close.

We recognize how important it is for the term and spread adjustment to be independently calculated and widely available across the market. As a result, we issued a request for proposal in February for an independent service provider to calculate and publish the adjustments. We expect to announce the successful vendor later this quarter.

Finally, we aim to amend the ISDA definitions in the fourth quarter to implement fallbacks for new contracts referencing the IBORs subject to consultation so far. We'll also publish a protocol to allow firms to modify their legacy trades to include the fallbacks. We expect the implementation date to be early 2020.

Once the alternative risk-free rate for euro – €STR – is published in October, we'll conduct a separate consultation on the term and spread adjustments for euro LIBOR and EURIBOR fallbacks.

As with the transition effort, a lot remains to be done, but the end is in sight.

EU Benchmarks Regulation

I'd like to finish my remarks by touching on the EU Benchmarks Regulation.

This regulation came into effect in January 2018, and includes a requirement for EU regulated firms to set out the steps they will take in the event a financial benchmark ceases to exist, materially changes or is not authorized for use.

That means if you trade with EU-regulated institutions, your contracts will need to include provisions that meet these requirements. Even if you don't trade with an EU counterparty, IOSCO recommends that parties globally implement similar plans for a cessation or material change to a benchmark.

To help firms respond to these requirements, ISDA published the ISDA Benchmarks Supplement and protocol towards the end of last year.

By using the supplement, firms can ensure these events are covered, and can specify the fallback arrangements that would apply. The protocol allows the supplement to be included in legacy trades quickly and efficiently.

Now, to be clear: this is a separate initiative to ISDA's work on IBOR fallbacks. For one thing, the ISDA Benchmarks Supplement covers a much broader range of benchmarks, including those referenced to FX, interest rates, equities and commodities.

Nonetheless, the two initiatives complement each other.

Once implemented, the IBOR fallbacks will take precedence for an IBOR cessation, but the ISDA Benchmarks Supplement will provide an additional level of protection.

Because the ISDA Benchmarks Supplement covers a wider range of events than the IBOR fallbacks, it also means firms will be able to specify primary fallback arrangements in the event a counterparty is no longer permitted to perform its obligations as a result of a benchmark failing to satisfy certain formal requirements for continued use.

We continue to engage closely with European regulators on the Benchmarks Regulation, and will work hard to make sure our members' views are communicated to policy-makers, particularly on the thorny issue of third-country benchmark equivalence, recognition and endorsement.

Conclusion

I'd like to close by reminding everyone how much progress has been made on benchmark reform in the 12 months since we last held this event.

Awareness of the issue is better than it was, and trading volumes in both futures and OTC derivatives referenced to the alternative risk-free rates are growing.

We expect that fallbacks for nine IBORs will take effect early next year. That will dramatically reduce the systemic threat of a permanent discontinuation of LIBOR and other IBORs.

We've also published the ISDA Benchmarks Supplement and protocol, giving market participants an efficient means of specifying fallbacks for events covered by the EU Benchmarks Regulation.

This time next year, we hope to have more good news to share. There's a lot to do, and you can be sure ISDA will be there each step of the way to provide all the support necessary.

Thank you.