ISDA Safe, Efficient Markets

Canadian Benchmark Reform – The Road Ahead
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Opening Remarks
Scott O'Malia, CEO, ISDA

Hello everyone, and welcome to our virtual event on Canadian benchmark reform. I'd like to take this opportunity to thank Bank of Canada for supporting and helping to organize this session. At ISDA, we're committed to raising awareness of benchmark transition globally, and events like these are a critical part of that effort.

A little over a month ago, we experienced one of the biggest upheavals ever to occur to financial markets – the termination of 24 LIBOR settings and the permanent non-representativeness of six others. It's difficult to underplay just how big a change this was. LIBOR was prevalent in virtually every sector of the financial markets, amounting to hundreds of trillions of dollars worth of contracts.

The fact we were able to navigate through this cessation event without serious market disruption is testament to the strong determination of regulators, central banks and financial institutions to tackle this issue, and the unprecedented level of cooperation and coordination between the public and private sectors.

Regulators and market participants confronted this challenge in a variety of ways, but a big part of the solution for the derivatives market was ISDA's work to develop robust contractual fallbacks. This ensured viable alternatives based on risk-free rates (RFRs) automatically kicked in for most non-cleared derivatives that continued to reference those 30 LIBOR settings after December 31, massively reducing the potential for systemic risk. The fallbacks also formed the basis for central counterparties to transition cleared LIBOR derivatives directly to RFRs late last year.

Those fallbacks don't just apply to LIBOR, however – they also cover a variety of other interbank offered rates (IBORs), including the Canadian Dollar Offered Rate (CDOR). With discussions on the future of CDOR now under way and a potential target date for cessation of June 30, 2024, it's important everyone active in the Canadian market understands how the fallbacks work and how they might impact outstanding CDOR trades.

I'd like to start my remarks by briefly outlining the mechanics of the fallbacks. I'll then describe what would need to happen in order to trigger those fallbacks for CDOR derivatives contracts.

So, starting with the fallbacks themselves. The ISDA 2020 IBOR Fallbacks Supplement and protocol came into effect just over a year ago, on January 25, 2021. From that date, all new derivatives that reference ISDA's standard definitions include the fallbacks for certain key IBORs, including CDOR, as a matter of course. By adhering to the protocol, firms can also incorporate the fallbacks into their legacy non-cleared derivatives with other adhering parties.

The fallbacks are based on risk-free rates but with an adjustment to reflect a portion of the structural differences between IBORs and RFRs. For derivatives linked to CDOR, the fallback is based on the Canadian Overnight Repo Rate Average, or CORRA.

Following multiple industry consultations, it was determined that the fallback for each IBOR setting will be based on the relevant RFR compounded in arrears with a shift, plus a spread adjustment calculated using a historical median of the differences between the IBOR and fallback rate over a five-year lookback period.

It's important to note that ISDA worked very closely with the Canadian Alternative Reference Rate (CARR) working group during the consultation process, as well as with other national working groups.

Now, this won't be new to many of you given the experience we recently had with LIBOR, so I'll quickly turn to how fallbacks would work in the context of CDOR.

As I'm sure all of you know, on December 16, the Canadian Alternative Reference Rate working group published a paper recommending that Refinitiv Benchmark Services Limited (RBSL) cease publication of all CDOR's remaining tenors after the end of June 2024 – although it emphasized the decision ultimately lies with RBSL as the administrator of CDOR.

Earlier this week, RBSL followed up with a consultation on the future of CDOR, with a deadline for comments of February 28.

Now, it's important to point out that neither the recommendation by CARR nor the consultation by RBSL represent a decision that CDOR ***will*** actually cease. As a result, neither meet the criteria for an index cessation event under the ISDA supplement or protocol, meaning the fallbacks have not yet been triggered for derivatives linked to CDOR and the spread adjustment for fallbacks has not been set.

That will only occur if and when RBSL announces that CDOR has ceased or will cease in future. Such an announcement would immediately trigger a fixing of the spread adjustment portion of the fallback rate, irrespective of the actual date of cessation when the fallbacks will kick in. This fixed spread will be published by Bloomberg, giving firms full transparency on the exact fallback rate that will apply.

Fallbacks play a critical role as a safety net, ensuring trades referencing an IBOR such as CDOR continue to function without disruption if and when cessation occurs. We strongly believe the introduction of fallbacks played a key role in smoothing the shift from 30 LIBOR settings over year end.

So far, more than 15,000 entities across the globe have adhered to the ISDA protocol, covering a large proportion of outstanding non-cleared derivatives trades linked to LIBOR, CDOR and certain other key IBORs. If you haven't yet adhered, there's still time – and we very much encourage you to do so.