International Swaps and Derivatives Association
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Opening Comments and Overview of Benchmark Reform Initiatives
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Good morning, everyone.

Let's cut straight to the chase. The reforms to strengthen interest rate benchmarks represent one of the biggest changes ever to occur to financial markets. I can think of no other event past or present that even comes close in terms of scale and impact.

Getting it done will not be easy. It will take significant time, resource and budget. But get it done we must. With over $370 trillion in total notional exposure to the IBORs, this is not something we can afford to ignore or leave to chance.

In my remarks this morning, I'll cover two important topics. First, I'll explain why it's so important for everyone to get up to speed with what the changes will mean and how it will impact them.

I'll describe the work that's being done to raise awareness of the issue and to support a smooth transition from the IBORs to risk-free rates, or RFRs. As part of that, I'll share with you some observations based on our IBOR transition initiative.

Our analysis shows awareness of the issue is rising, but plenty of work remains to be done. It's vital that we focus on that work now. Everyone needs to get engaged with this issue, and mobilize their organization. We need to work together to ensure the benchmark reforms occur in an orderly way that avoids disruption. ISDA is committed to supporting the industry through this process.

Second, I'll describe ISDA's work to develop robust fallbacks for derivatives contracts that reference certain key IBORs. This work is critical to ensure the viability of derivatives transactions, and to minimize the disruption that would occur if an IBOR is permanently discontinued.

IBOR Transition Initiative

From derivatives, to loans, to mortgages, to deposits – the IBORs saturate financial markets. Shifting to alternative risk-free rates will therefore have ripple effects across financial markets, affecting everyone from the most sophisticated derivatives traders to mom-and-pop investors.

So, why are we doing it?

The simple fact is that there are real concerns about the robustness and viability of some IBORs given the sharp decline in activity in the unsecured bank funding market. Given the limited number of actual transactions, and with fewer banks willing to contribute, the appropriateness of the IBORs has been called into question.

In the case of LIBOR, the UK FCA has stated very clearly that it won't compel or persuade banks to make submissions after the end of 2021. It's therefore critical that we have alternatives up and running before then. However, we must also be realistic about the potential for all participants to fully transition to a new overnight rate by 2021. There are specific considerations that I'll come back to in a minute.

Of course, not every market is the same. In some jurisdictions, it's possible that an existing IBOR may exist hand in hand with the new RFR. Under this so-called multi-rate regime, the IBORs might continue to be used as a reference rate for certain products and transactions – for instance, corporate loans. In other cases – for instance, derivatives – it might be more appropriate to use an RFR.

That's an approach Europe, Japan and Australia have suggested they will take for their regional IBORs – EURIBOR, TIBOR and BBSW, respectively. We're fortunate to have Guy Debelle, deputy governor of the Reserve Bank of Australia, as our first keynote speaker this morning. I'm sure he'll set out the path Australia intends to take in more detail.

Work to identify and adopt RFRs has been ongoing for some time, and significant progress has been made. Public-/private-sector RFR working groups in several jurisdictions, including the US, UK and Japan, have identified alternative risk-free rates, and have begun developing strategies for transition.

Their remits have recently been updated, and they've broadened their outreach to cover additional products and market participants – for example, those in the bond, loan and other cash markets. RFR subgroups have also been formed to tackle specific products and topics, such as accounting, tax, legal, regulatory, communications, outreach and risk-free rate term structures.

Survey to Assess Market Readiness

To assist in the effort to raise awareness of the issue and support a smooth transition, ISDA and our partner trade associations have launched an IBOR transition initiative. As the slide shows, this comprises three parts. As a first step, we released our benchmark transition roadmap, which summarizes the work done so far on the selection and adoption of risk-free rates in order to increase awareness and understanding. That was published in February, and if you haven't had the opportunity to read it, I'd strongly encourage you to do so.

The next stage was to conduct a global survey of market participants to determine the issues they face. That survey is now complete, and the results will be published as part of our IBOR global benchmark transition report – the third part of the initiative, which is scheduled for release next month.

The purpose of this initiative is threefold: to help raise market awareness; gauge the state of readiness; and outline possible next steps for the transition. This is meant to complement the work being done by the RFR working groups, and to support industry efforts to adopt the alternative RFRs.

While the results of the survey are not yet final, I'd like share some of the themes and trends that we have observed.

Observations

Four key themes have emerged fairly strongly. First, we have seen levels of awareness rising. In fact, many of our member firms have begun initial work to identify exposures and prepare for transition. However, market participants feel they need more information on what they need to be doing and when.

Firms have identified a number of issues that need to be resolved to ensure a smooth transition, but some – like ensuring sufficient liquidity in derivatives referencing the RFRs – are likely to be priorities.

Finally, the development of robust fallbacks is seen as critical.

The fact that awareness levels appear to be rising is clearly positive, and reflects the outreach conducted so far by the various public-/private-sector RFR working groups and trade associations like ISDA.

Our members tell us they are concerned about their firm's exposure to the IBORs, and have started to address the risk. Some have even commenced internal discussions on the transition to alternative RFRs, with a smaller proportion at the stage of allocating budget or developing a preliminary project plan.

However, more needs to be done – many firms have not yet started projects to transition to the alternative RFRs.

Clearly, further work is needed here, so market education is an obvious near-term priority. Market participants appear to want more centralized and coordinated information, and they want updates on a regular basis in order to inform their transition planning.

Turning to the issues that need to be resolved.

Importantly, both regulators and market participants have stressed the need for widescale adoption of the alternative RFRs.

Linked to this is the need to develop liquidity in OTC derivatives and futures markets referencing the RFRs. Clearing services for those products also need to be up and running.

Elsewhere, market participants have highlighted valuation and risk management issues. These would primarily apply if market participants choose to voluntarily amend existing transactions to reference alternative RFRs instead of the IBORs.

The absence of forward term fixings is a key issue. The IBORs are currently available in multiple tenors – one, three, six and 12 months – but the RFRs are only available on an overnight basis. This could pose particular complications for certain types of products like floating rate notes, which are traded on the basis of known interest payments at the next interest payment date.

The RFR working groups are looking at this issue, and are considering the feasibility of a forward-looking term fixing for the various RFRs.

Addressing Fallback Rates – Preparing a Market Consultation

Another major challenge is what happens to those contracts that reference an IBOR if that benchmark is permanently discontinued at some point in the future.

As it stands, current fallback provisions are not robust enough to eliminate uncertainty should an IBOR cease to exist.

That presents a real systemic risk, so it's critical we identify and implement robust fallbacks as soon as possible. It's like having a lifebuoy at a swimming pool. You hope you'll never need to use it, but if the worst happens, having it there could make the difference between survival and disaster.

This is a big focus for ISDA, and we've been working on an initiative since 2016 at the request of the FSB's Official Sector Steering Group to specify fallbacks that can be written into derivatives contracts that reference certain key IBORs.

The fallback rates are expected to be the RFRs selected by the public-/private-sector working groups. Key issues include how to deal with the fact that IBORs reflect bank credit risk while RFRs do not, and how to approach term fixings.

In both cases, it is likely that adjustments will need to be made to ensure contracts continue to function as closely as possible to what was intended if the fallback kicks in.

We will very shortly release a market-wide consultation on the credit spread methodology and term fixing adjustments that should apply for derivatives fallbacks.

The consultation will set out several approaches to term RFR fixings, and several methodologies for calculating a credit spread. These include a forward rate approach, a historical mean approach and a spot spread approach.

The various methodologies were chosen based on key criteria: minimizing value transfer; minimizing the possibility for manipulation; and minimizing the effects of any distortions in the market at the time the fallback is applied. We encourage market participants to consider these criteria and other issues they feel to be appropriate when responding to the consultation.

This consultation will be open to everyone, not just ISDA members. We need your views on this. The success of the fallback implementation ultimately depends on broad market input on these issues.

Once agreed, a vendor is expected to publish the relevant credit spread and any term fixing adjustments to ensure transparency and avoid the need for market participants to perform their own calculations. The fallbacks will be incorporated into ISDA's 2006 interest rate definitions, and will therefore apply to new cleared and non-cleared derivatives that reference the definitions.

We also expect to publish a protocol to allow market participants to incorporate the fallbacks into existing trades.

So, what are the immediate next steps?

The public-/private-sector RFR working groups will continue to ramp up their outreach and communication efforts, with an eye to raising awareness about interest rate benchmark reform across the whole market. They are also working on some of the issues identified by market participants – for example, the need to foster liquidity in derivatives referencing the new RFRs.

ISDA and our partner trade associations will shortly publish the IBOR global benchmark transition report, which will further raise awareness of the scale of the issue.

ISDA will also soon issue a market consultation on the proposed credit spread methodology and term fixing adjustment for derivatives fallbacks. I can't stress enough how important this is. Please make sure your voice is heard.

We all have an interest in making sure benchmark reform occurs smoothly. That's why everyone needs to get engaged with this issue now, share ideas and develop solutions that work for all. The efficient functioning of the financial markets could depend on it.

I'd like to finish by thanking you all for attending. I'd also like to thank Bloomberg for working with us in putting on this event.

Whether you are just starting your benchmark reform or are well advanced, I hope you find today's event useful.