Mr Alp Eroglu
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

May 2013

Public Comment on Financial Benchmark Principles, IOSCO

International Swaps and Derivatives Association, Inc. (ISDA)[1] response

On behalf of our members, ISDA appreciates the opportunity to respond to this consultation, with the goal of contributing to a robust and stable financial market. In this response, we have limited ourselves to commenting on those issues that are directly relevant to ISDA and OTC Derivatives Markets. There are, of course, many important issues discussed in the consultation document that go beyond that product scope, and we defer, in relation to those issues, to other financial market respondents with greater expertise and/or a more relevant focus.

Our responses to selected questions can be found in full in the accompanying Annex 1.

Our submission reiterates key ISDA concerns around financial benchmarks (eg. benchmarks in the interbank market, including LIBOR). In general, we very much welcome ISOCO principles. At the same time we would call for a more explicit recognition of several issues, especially around documentation, legal certainty and hybrid methodology. Regarding the treatment of oil price reporting agencies (PRAs), we would like to refer to our previous responses.[2]

HIGHLIGHTS

- In relation to any **transition** to alternative benchmarks, there should be clear and long term arrangements in place. Failure to achieve a smooth and progressive transition will result in major market dislocation and significant "jump risk" if there is an abrupt move from old benchmarks to a successor. **We would encourage IOSCO to explicitly recognise that the rate of any transition will likely be chiefly determined by the speed of migration to an alternative in terms of liquidity**, as well as the extent to which market participants have amended their **documentation, and have set-up and modified their internal systems and processes**. We would like to highlight that in order to avoid market disruption, **it is in particular imperative that there is legal certainty as to the continuity of outstanding contracts** referencing the

[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC 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 including exchanges, clearinghouses 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 web site: www.isda.org.

[2] http://www2.isda.org/attachment/NTMwNQ==/20130211_IOSCO_Benchmarks_ISDA_final_response.pdf
http://www2.isda.org/attachment/NTMzMQ==/20130215_EBA_ESMA_Benchmarks_ISDA_final_response.pdf
http://assets.isda.org/media/dbb472c0/6ea5511a.pdf (March 2012, IOSCO Oil PRAs, ISDA response)
http://www2.isda.org/attachment/NTExMA==/EC%20CONSULTATION.%20INDICES%20.FINALRESPONSE%20.291112.pdf.pdf

existing benchmark. **We would welcome the opportunity to work further with the authorities on how this could be taken forward.**

- Regarding a **hybrid methodology** for calculation purposes, we generally support the use of actual trade data (where available) in benchmarks' compilation. **At the same time, we believe that it will still be necessary to deploy algorithms or expert judgment to fill the gaps where no trade data exists. We would encourage IOSCO to explicitly recognise this**. In fact, we would argue that expert judgment still plays a part even where actual trade data exists, given that the decision to transact the trade(s) in practice depends upon the exercise of such expert judgment.

- In general, we would support the recognition that there is **not a one size fits all regulatory approach** to all benchmarks. Considerations need to be taken into account as to who is contributing to it and who is ultimately using the rate, and an informed assessment needs to be made as to what is appropriate

- Therefore, **ISDA encourages IOSCO to take account of the distinction between a) key public benchmarks** that are primarily used for purposes of pricing a broad range of financial instruments or contracts **and b)** benchmarks in the broader sense (including **proprietary indices**). In short, not all indices should be regarded as a 'public good' and this should be reflected in the design of any regulation.

- ISDA developed **ISDAFIX** to facilitate the determination of exercise values for cash-settled swap options and termination value for swaps. Such a benchmark provides a transparent, readily available value to which parties to a transaction can refer as a settlement rate. Without such a benchmark, it might be necessary to go through the process of calling a number of active dealers for quotes in order to settle transactions. For more information on ISDAFIX please refer to http://www2.isda.org/asset-classes/interest-rates-derivatives/isdafix/.

- Regarding commodity derivatives, we would just like to stress that many benchmarks are important for the functioning of the markets. Exchange-traded benchmarks including CME/ NYMEX, ICE and CRB as well as benchmarks of price reporting agencies, are used to price physical markets and, indirectly, derivatives and hedging instruments. In this respect, ISDA would like to make some general points regarding commodities markets:
    - Physical indices have a degree of subjectivity for two primary reasons: (1) the diversity in physical qualities requires an assessment of value; and (2) the fact that certain physical oils may not trade continuously, requires an assessment of where value is likely to be;
    - The physical markets reflect the supply/demand fundamentals, and financial markets derive prices from there - not vice versa.

- Regarding more specifically PRAs, ISDA supports the work that has been done by IOSCO on self-governance.

- We very much welcome the general IOSCO remarks on a **proportional implementation** of principles, including through **regulatory actions only where appropriate**. In this context we would favour **adding a clear principle that governance and the application of regulation should always be considered on a careful assessment of the associated costs (eg. potential market disruption impact) against the expected resulting benefits**.

- In relation to future reforms, there should be alignment with **existing regulatory initiatives and proposals should be co-ordinated on a global basis to reflect the markets they relate to**. Particularly, if transactions are to be reported, then existing reporting databases, systems and reporting routes should be leveraged.

We have pleasure in submitting our response, and look forward to staying very much engaged with IOSCO as regards future initiatives on this topic.

Yours faithfully,
George Handjinicolaou

Deputy CEO and Head of ISDA Europe, Middle East and Africa
International Swaps and Derivatives Association, Inc. (ISDA)

ANNEX 1: CONSULTATION QUESTIONS & RESPONSES

General description of benchmarks used by ISDA members

ISDA has more than 800 members from 60 countries. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearing houses and other service providers.

As a result, **our members are using a wide range of benchmarks for different purposes**. Among them, the following may be noted:

- EURIBOR and LIBOR are used to price notional interbank loans as a reference for interest rate swaps, as well as to price commercial loans or be the reference interest rate in a retail mortgage or consumer credit contracts;
- EONIA, which indexes actual overnight transaction rates (in euros – just as SONIA does for sterling);
- Overnight Index Swaps ('OIS') are based on such an index of overnight rates;
- ISDAFIX, to facilitate the determination of swap termination values and exercise values for cash-settled swap options.

In the commodities markets, exchange-traded benchmarks including CME/ NYMEX and ICE (Oil complex, Natural Gas, soft commodities, metals), CRB (commodities) as well as benchmarks of price reporting agencies (Platts, Argus, ICIS, McCloskey, Point Carbon), are used to price derivatives and hedging instruments.

ISDAFIX is the leading benchmark for annual swap rates for swap transactions worldwide. This screen service provides average mid-market swap rates for five major currencies at selected maturities on a daily basis. ISDAFIX rates are based on a midday polling and, in some markets, an additional end-of-day polling of mid-market rates. ISDA established ISDAFIX in 1998 in co-operation with Reuters (now Thomson Reuters) and Intercapital Brokers (now ICAP plc.).

ISDA developed ISDAFIX to facilitate the determination of exercise values for cash-settled swap options. The existence of such a benchmark provides a transparent, readily available value to which parties to a transaction can refer as a settlement rate. Without such a benchmark, it would be necessary to go through the process of calling a number of active dealers for quotes in order to settle transactions. The 2006 ISDA Definitions refer specifically to ISDAFIX rates as a means of settlement of over-the-counter derivatives transactions. In the sample Swaption Confirmation in the 2006 ISDA Definitions (Exhibit II-E), for example, the parties can include 'ISDA Source' - that is, ISDAFIX - as the reference settlement rate under Settlement Terms.

ISDAFIX is also used as a reference rate for cash settlement in connection with early terminations of swap transactions. In addition, dealers often use ISDAFIX as an input when marking their swap portfolios to market.

Beyond their use in settling over-the-counter-traded transactions, ISDAFIX rates are also used as a rate or curve source in various exchange products. LIFFE, for example, uses ISDAFIX as the source of the swap curve in calculating the settlement price of its Swapnote futures contract. In addition, both the Chicago Mercantile Exchange and the Chicago Board of Trade use ISDAFIX as the settlement price in their swap futures contracts. In the United States, the Federal Reserve uses ISDAFIX as the source for USD swap rates in its H.15 Statistical Release.

At present, ISDAFIX provides rates for euro (EUR), Japanese yen (JPY), British pound (GBP), Swiss franc (CHF) and U.S. dollar (USD). (The Hong Kong dollar rate was suspended in April 2013, because there were not sufficient contributors to continue it.) In addition, ISDAFIX provides USD swap spreads (ie, the difference between the absolute fixed rate in the swap and the comparable government-bond rate). Contributed rates are collected by Thomson Reuters or ICAP, tabulated and then posted alongside the calculated ISDAFIX rate on the applicable Thomson Reuters screen at various times throughout the day.

Specific remarks

*1. **Equity indices**: Indices may be used to measure a wide range of underlying Interests, using a variety of calculation methodologies and inputs. In the specific case of equity indices, inputs are typically based on transactions concluded on Regulated Markets. In light of this: are there any principles or parts of the principles that cannot, or should not, be applied to equity indices? If so, please identify these principles and explain why their application is inappropriate.*

*2. **Additional measures to address risks resulting from Submission-based Benchmarks or ownership or control structures**: Additional measures have been specified within certain principles to address specific risks arising from a reliance on Submissions (principles 4, 10, 13 and 17) and/or from ownership or control structures (Principles 2, 5 and 16).*

> *a. Should these additional requirements apply to Submitters and Administrators of all submission-based Benchmarks or Benchmarks with the specified ownership/control structures?*
>
> *b. If not, please explain why all or some submission-based Benchmarks or Benchmarks with the specified ownership/control structures should be exempt.*

Concerning the application scope of the principles in general as well as certain specific comments on submission-based benchmarks regarding principles 10 and 13, please see our answers to question 4.

*3. **Notice Concerning Use of Expert Judgment**: Should Administrators be required to briefly describe and publish with each benchmark assessment:*

> *a. a concise explanation, sufficient to facilitate a User's or Market Authority's ability to understand how the assessment was developed, terms referring to the pricing methodology should be included (e.g., spread-based, interpolated/extrapolated or estimate-based); and*
>
> *b. a concise explanation of the extent to which and the basis upon which judgment (i.e. exclusions of data which otherwise conformed to the requirements of the relevant methodology for that assessment, basing assessments on spreads, interpolation/extrapolation or estimates, or weighting bids or offers higher than concluded transactions etc.), if any, was used in establishing an assessment.*

General remarks on use of data and expert judgement

We generally support the use of actual **trade data** (where available) in benchmarks' compilation. At the same time, we acknowledge that it will likely still be necessary to deploy algorithms or expert judgment to fill the gaps where no trade data exists, subject to appropriate governance. In fact, we would argue that, expert judgement still plays a part even where actual trade data exists, given that the decision to transact the trade(s) depends upon the exercise of such **expert judgment**.

Moreover, it should be noted that **liquidity** - specifically liquidity of the underlying - can vary over time and therefore benchmark setting rules should vary accordingly. For example, relatively new markets are likely to be less liquid. These points are relevant especially in the context of emerging markets. We believe that where there is a lack of data, the benchmark administrator should provide guidance on how to get over a transition period.

Separately, many ISDA members maintain **proprietary indices** to help track the performance of a particular asset class or sector, and potentially to determine the pay-off on bespoke derivatives and structured products, including exchange-traded funds (ETFs), notes, certificates and warrants. A proprietary index might reference a basket of securities relating to a particular sector or market (a basket of emerging market securities, government debt, corporate debt), or physical assets, such as commodities (precious metals, energy resources, for example), or a combination of asset classes and sectors. Typically the value of such indices is derived from market data on its constituent assets, collected and weighted according to the documented, rules-based methodology of the index. The internal governance structures designed around the development of these proprietary indices may require the calculation, or at least the verification, of the levels of such indices by independent third parties. The existence of such indices allows an investor to gain exposure to a given sector or class of assets (i.e., making it easier to gain exposure to multiple reference assets), whilst avoiding many of the difficulties and costs associated with arranging a direct investment in the underlying reference assets.

Finally, in relation to **wholesale energy markets**, eg. indices and benchmarks produced by PRAs are based on actual transaction data, on bids and offers and on opinion obtained from a panel, in that order of preference.

Therefore, regarding **principle 7 on data sufficiency**, we welcome the IOSCO rules which, as we understand, allow for the use of non-transactional data for indices that are not designed to represent transactions, as well as permit administrators to relay upon expert judgment in an illiquid market (as equally recognized in principle 8 on hierarchy of data inputs).

However, we would like to submit that the proposed principles must in addition **recognise explicitly** that expert judgment is or may have to be exercised in submissions to a benchmark rate in the circumstance where there is an absence of sufficient relevant transactional data as a reference point.

In particular, we strongly believe that the following statements on data use are far too prescriptive:

- Construct of a benchmark should be based on prices, rates indices or value determined by supply and demand, and be anchored by observable transaction;
- Administrators may rely on non transactional data and adjustments based on expert judgements but only as an adjunct or supplement to transactional data.

This is because these statements do not capture all instances of where expert judgment may be used (as mentioned above, eg. absence of data).

Therefore we would strongly suggest adding an additional principle:
'Expert judgement may be exercised in the absence of sufficient relevant transactional data.'

Regarding principle **8 on hierarchy of data inputs,** we would like to welcome a **clarification** that a prescriptive hierarchy of data inputs may not be appropriate. This is because in some markets with not much liquidity, expert judgments may be more important then transaction data.

Regarding **principle 6 on benchmark design**, we would welcome a **clarification** that point '**b)**' does not mean that rules should require a sufficient liquidity of underlyings. As stated above, it ought to be recognised that liquidity can vary over time and therefore such an interpretation of this rule would not always be possible to adhere to. Moreover, any controls consisting in comparisons of submitted data with actual transactions could be difficult in cases of low liquidity. Such 'liquidity' rules, we believe, should rather be understood as requiring that where there is a lack of data (eg due to low liquidity) the benchmark administrator would need to provide guidance on how to get over a temporary or transition period.

Regarding **principle 9 on periodic reviews**, we would welcome recognition of the fact that the frequency of these reviews would differ depending on benchmark.

Specific answer to question 3

All *public* benchmark rates should have specific, transparent and published processes detailing how the final published rate is calculated.

We believe that the key point is that the confirmation of compliance with the relevant principles (including on the use of expert judgement) should function as a clear and robust process mainly based on communication with the relevant competent oversight body, rather then be based on a vague public disclosure process. We would very much favour an **inclusion** of such a principle. Moreover, we would welcome an explicit **recognition** that a potential introduction of such a requirement should be considered on a case by cases basis, depending on the type of benchmarks concerned. In particular, the feasibility of regulatory disclosure (versus public disclosure) should be appropriately considered for bilateral, non-public benchmarks. Confidentiality issues should also be taken into consideration, depending on the level of detail to be published.

4. Revisions to the principles*: Please provide any suggested changes to specific principles or definitions of key terms set out in Annex A, including drafting proposals and rationale.*

Are any other principles needed*: Should principles to address any additional issues, risks or conflicts of interest be developed? Please provide a summary of the issue and drafting for the proposed principle.*

General principles on benchmark regulation – implementation of IOSCO principles

We very much welcome the general IOSCO remarks on a **proportional implementation** of principles, including through **regulatory actions *only* where appropriate**. In this context we would favour **adding a clear principle that governance and the application of regulation should always be considered on a careful assessment of the associated costs against the expected resulting benefits**. Market impact of the index or benchmark is a further important factor and it is clear that many index/ benchmark prices are important for the functioning of the markets. To give one example, IOSCO has considered this balance in its review of oil price reporting agencies, in which it recommended that appropriate protections and governance are put in place through self-regulatory principles for PRA benchmark governance. PRAs are thus encouraged to comply subject to independent audit. If satisfactory compliance is not achieved, then other policy instruments, including applying a form of regulation of PRAs should be applied.

Index providers fulfil a high impact and critical role in many markets and as an association of market users, we support any measures designed to ensure that appropriate standards are achieved, provided these can be justified on a cost benefit basis.

In brief, we see the following advantages and disadvantages of making benchmark setting a regulated activity:

Disadvantages:

- Associated cost for both administrators and submitters,
- Firms may consider the risks and costs associated with contributing to be too onerous, and a consequent reduction of liquidity could damage assessment of what are in many cases already relatively illiquid markets.

Advantages: Controls would be tighter.

Governance

In the above context, we consider the following **governance and transparency arrangements** to be important to ensure the integrity of benchmarks:

- Appropriate seniority of and responsibility of staff (so less open to being influenced);
- Complaints process – need for a framework for raising concerns (independent of benchmark
- contributors);
- Appropriate consultation with users on changes;
- Systems and controls which lead to reliable daily operations;
- Transparency of methodology, of operation and application of any judgement.

We however would again welcome a **recognition** that there is no a solution that would work for every benchmark. Each benchmark should be assessed on its own merit and suitable procedures put in place.

Regarding **principle 1 on overall responsibility of administrator**, we agree that regulatory burdens relating to index/benchmark production should primarily fall on the provider of the benchmark, as it has ultimate control over and responsibility for the price publication. Many participants who submit to indices/ benchmarks are regulated firms themselves, so extension of regulation to further activity represents additional incremental cost. Again, we consider that any such extension should be considered on a cost-benefit basis. Benchmarks/ indices provide essential transparency to markets and it is important not to impose regulatory burdens which may deter legitimate participation in these processes.

Concerning **principle 5 on internal oversight**, we would also like to underline that benchmarks and indices provide essential transparency to markets and it is important not to impose regulatory burdens which may deter legitimate participation in these processes.

Regarding the 'independent oversight function', as mentioned on the page 16 of the IOSCO consultation, we would like to stress that it is important that there is a sufficient expertise within this function.

Scope

While we would support that all benchmark sponsors should be cognisant of future rules on benchmark governance when designing a controlled environment, it should be proportionately applied depending on the nature and significance of a particular benchmark. Our members are mindful of the need for adequate systems and controls and feel that by retaining more flexibility, they can ensure governance is proportionate to the risks of the business. Requiring adherence to future regulatory arrangements for 'any commercial indices' is likely to be impractical, costly and potentially disproportionate to their market significance.

Therefore, we welcome that IOSCO recognizes the diversity of benchmarks universe, does not expect a one-size fits all implementation and seems to encourage regulatory actions only when appropriate.

IOSCO also mentions, in the feedback statement, that many respondents wanted to exclude private bilateral benchmarks. We would very much welcome **further steps to recognise the differences between public and private benchmarks**.

In this context, we would like to re-encourage IOSCO to take account of the differences between key public benchmarks and benchmarks in the broader sense (including proprietary indices). In short, not all indices should be regarded as a 'public good' and this should be reflected in the design of regulation.

Some ISDA members regularly produce **customized** indices that are used for pricing bespoke **bilateral** or similar transactions among a **limited number of counterparties**. We note in many cases that these customized indices should not fall under the scope of the report. Examples would include customized or privately-negotiated indices, reference portfolios or baskets, defined in connection with specific issuances of structured notes, with bespoke transactions to effect investment strategies, or with similar bilateral or limited arrangements. The indices or baskets come in many forms and are in many cases subject to product regulation as a result of the products with which they are used. In some cases the indices or baskets are more connected with the products they are used with and are not free-standing benchmarks which could be separately regulated.

In our view, a regulation should consider the function of a particular benchmark (governance, controls, management, conflict of interest, etc.). In respect of proprietary indices, we believe that adequate regulatory protections already exist, reflected in a number of pieces of European legislation:

- MiFID rules on suitability and appropriateness and on the management of conflicts of interest;
- Recently enhanced Prospectus Directive disclosure provisions relating to indices; and
- Recently enhanced UCITS provisions on the eligibility of a particular index.

Given that proprietary indices are today already subject to a number of governance mechanisms, the main consequence of additional rules in respect of proprietary indices (e.g. the mandatory use of third party calculation agents) beyond governance arrangements already in place would be to increase costs borne by the end investor or otherwise reduce investor choice, without advancing in a meaningful way the level of protection provided to the investor.

Moreover, proprietary indices used by ISDA members are designed to help particular clients implement specific investment strategies or achieve particular investment objectives, rather than to capture or approximate a transaction (e.g. the cost of borrowing in the interbank market, in the case of Libor). Therefore, the policy measures that may be applied to public benchmarks are unlikely to be appropriate for private indices. For example, **the level of transparency (especially public transparency, as opposed to transparency to regulators) that might be expected of a public benchmark could not readily be extended to private indices, which essentially constitute intellectual property, without undermining the ability of firms to offer their clients products that offer specific exposures in a cost-effective manner**. As noted above in many cases these indices are already subject to product regulation, including disclosure requirements in legislation such as the Prospectus Directive or UCITS legislation.

Quality of methodology

We welcome **principle 10 d** on the need for **contingency** procedures. We agree that all *public* benchmark rates should have specific, transparent and published processes detailing how the final published rate is calculated. If deemed appropriate, specific measures should be set out detailing if any sort of contingency plan could be invoked in the case of, for instance, severe local circumstances which would prevent a rate from publishing per the standard fixing methodology.

An example of this would be in the case of a benchmark which is fixed via a calculation based on a number of panel bank submissions, but fixes only when a minimum level of contributions are received within a certain timeframe.

In this case we would welcome a **clarification** that a contingency plan could involve extending the usual window for submissions, lowering the minimum level of contributions required, etc. We consider it essential that any sort of contingency plan is transparent and we would also welcome the principle that it should only be invoked per the stated definition.

We also support **principle 11** on procedures for **making changes to the methodology**. In addition we would welcome an explicit **recognition** that there is no single solution that would work for every benchmark. Each benchmark should be assessed on its own merit and suitable procedures on notifications of changes should be put in place. We also welcome the recognition of the need for consultation. We would support a clear **statement** that changes should be consulted with all involved parties, including users of benchmarks, eg with regard to review schedule.

On principle 11, we also believe that with regard to the **situation where submitters want to leave the panel**, administrators could request that a notice is given. However, if submitters stop contributing abruptly there are limitations as to how administrators can manage such situation. We believe that such situations would be addressed by the code of conduct and be linked to the integrity of submitters.

Regarding **principle 13.e. and 13.f.**, on the policies to discourage the interim withdrawal of submitters from surveys and panels as well as on policies to encourage submitters to submit all relevant data, we acknowledge that there is a tension where indices rely on voluntary contributions. Though we believe that it should be **flagged** that if powers to compel participants in financial markets to make submissions to benchmarks exist, they should only be used as a last resort, and where there is a significant risk of widespread disruption. Thought should be given to which body would have power to compel an entity to make a submission to a specific index, particularly where that entity is not regulated. If powers to compel participants in financial markets to make submissions to benchmarks are exercised, it is important that such participants can benefit from "safe harbours" for so long as they act within the scope of the rules of the relevant index.

Transition

In general, regarding market movement between a benchmark and its replacement, ISDA believes that there should be **clear and *sufficiently long term* arrangements in place to manage any transition** to alternative benchmarks. Failure to achieve a smooth and progressive transition will result in major market dislocation and significant ‘jump risk’ if there is an abrupt move from old benchmarks to a successor. The general procedures put in place to govern any changes to methodology and transition must allow for practitioner consultation and input. A review schedule should be consulted with all involved parties, including users of the benchmark. Suitable notification procedures should be put in place. Therefore we broadly very much welcome the IOSCO principles in this respect.

In this context, we would like to make a particular remark that, in some cases of a benchmark discontinuation, *a* solution could be that old benchmarks and new benchmarks may be allowed to be used in parallel, in order to give the market sufficient time to adapt itself to the new environment and allow contracts referencing old benchmarks to run until the maturity. However, for some financial products there may be no alternative benchmark to use. In such cases a sufficient adaptation time is crucial.

We would also encourage IOSCO to **recognise** that the rate of any transition **will likely be chiefly determined by the speed of migration** to an alternative in terms of liquidity **as well** the extent to which market participants have amended their **documentation, and have set-up and modified their internal systems and processes**. Moreover, we think that **individual benchmarks** should be assessed on their own merit. We do not think that there is a solution that would work for every benchmark. We also encourage policymakers to ensure **international coordination** and alignment of changes which relate to international markets.

We would like to suggest to IOSCO **highlighting** that, in order to avoid market disruption, it is in particular imperative that there is **legal certainty as to the continuity of outstanding contracts referencing the existing benchmark**.

We have set out some of the issues below. **We would welcome the opportunity to work further with the authorities on how this could be taken forward.**

In particular, in this response, we have limited ourselves to providing detailed comments mainly regarding the challenges created by a transition to future contracts from contracts relying on Libor or other benchmarks in the interbank market.

As the trade association for OTC derivative products, our comments below relate solely to those products, whilst recognising that changes to Libor or a transition away from it will also impact other products in other markets which often underlie **OTC derivatives transactions**. Within the OTC derivatives markets, interest rate derivatives are the most heavily affected asset class. We offer some detailed analysis of how trades might be affected by changes to or a move from Libor, according to the terms of their ISDA documentation and in the wider context of incident legal risk.

The majority of OTC interest derivatives transactions use Libor rates as the reference rate for floating legs of transactions. These transactions are typically **documented** under an **ISDA Master Agreement and a trade Confirmation**, which will reference the relevant published **ISDA Definitions**. The Definitions give formal and detailed descriptions for all of a transaction's variables that will be referenced in the trade Confirmation. In other words, the Definitions remove the need to restate the often lengthy descriptions of commonly-used trade attributes in Confirmations. This has an important risk reducing effect in that it enables rapid (often electronic) turnaround times, given that the Confirmations can be brief in that they refer to, rather than restate the Definitions. The main operative booklet of definitions with respect to Libor is the "2006 ISDA Definitions".

In essence the **definitions** of Libor rates are **page-driven**, by which we mean that the rate for (say) GBP Libor is defined as being the rate that appears on Reuters screen LIBOR01 (or an equivalent page in the case of the Bloomberg definition). Defining the rates in this way means that the Definition should be able to accommodate a certain amount of change to the rate in terms of methodology of compilation, for instance, so long as the rate still appears on the given page.

Clearly, however, there are **limits to** this and as **changes** become more economically significant, and to the extent that Libor is fundamentally changed into something else (even if its description does not change and even if it continues to fall within the strict wording of the definition), so the risk increases that parties may claim, under **doctrines of frustration** or otherwise, that the contract is not what they bargained for. The definition provides that where the rate is not published at all, parties will revert to the **polling** of specified numbers of so-called "Reference Banks" to arrive at a rate themselves.

ISDA member firms support the final **proposals the BBA has made in terms of** the currencies and maturities for which **LIBOR** will be discontinued and has worked with the industry to provide guidance in order to minimise the market disruption resulting from the changes to LIBOR.

Of the 5 **currencies** discontinued or to be discontinued, ISDA only publishes definitions for the AUD and CAD rates. Parties using any of the other 3 rates will presumably have had to define these rates in their own bespoke documentation and would need to act in accordance with its terms in the event of discontinuation. That said, we suspect trade volumes here to be very low. With respect to AUD and CAD, data from the DTCC Global Trade Repository indicates there is only a handful of extant trades, meaning that the Reference Banks fall-back should work effectively i.e. that firms should be able to conduct polls, albeit manually, in order to calculate a rate, or else firms can bilaterally agree to terminate trades or to use an alternative, suitable local rate.

The discontinuation of the specific **maturities** presents more of a problem, as we believe the outstanding number of trades to be such that the market would not be able to support a trade by trade solution. In addition, the “Reference Banks” mechanism for determining rates for discontinued maturities faces the same issue that the Wheatley Review is looking to resolve, i.e. no transaction data to corroborate submissions. This essentially means that the industry needs to seek a solution to deal with this effectively.

The problem that exists is that the majority of confirmation documents are unlikely to specify the use of interpolation for trades with discontinued maturities. The only way to legally change a confirmation retrospectively is for the parties to agree to that amendment. Agreeing and affecting such amendments bilaterally could be cumbersome depending on the level of trades affected. ISDA could in principle facilitate this process by publishing a **protocol** or bilateral amendment letter, which firms would need to adhere to in order to amend their contracts with the other parties. For the purpose of the maturities of Libor that will be discontinued, ISDA member firms agreed that a bilateral amendment letter would be sufficient. The letter can be tailored as appropriate by firms and was published to allow sufficient time prior to the discontinuations being effected for firms to have the amendment agreed with counterparties. This is, however, a voluntary process and both parties would need to adhere to the letter for it to be useful.

Should discontinuation be considered for **other benchmarks in the interbank market,** a few general issues need to be taken into account. An initial obstacle here in the interbank market will be that the parties will need to agree upon which **Reference Banks** to approach, if this is the defined or agreed fallback, should a benchmark no longer be available. Once agreed, **polling** can take place, however it is possible that strictly speaking thousands of polls may need to be conducted on a trade by trade basis and it is highly unlikely the market could support this burden of activity. Even if all the polls were conducted in a timely and orderly manner, each would yield a different result. This would mean that a party with (say) 2 resetting trades with 2 banks could see those trades reset at different levels.

Changes would be required to the standard ISDA **documentation** to give effect to changes, once their details were known, or to address the consequences of the outright discontinuation of an interbank rate, both in respect of the ‘back book’” of legacy trades and to cover new trades on a going forward basis. The market would need to migrate to a successor rate or rates (pre-existing or otherwise) in respect of each rate that was discontinued, be that a more minor rate such as AUD or a major one such as GBP. ISDA could publish Supplements to its Definitions to facilitate changes to contracts necessary to reference any newly-published successor rates.

To facilitate the use of successors in legacy trades, ISDA would likely publish a **Protocol** which would have the effect of amending OTC derivatives contracts between adhering parties so as to convert their back book trades to reference the agreed successors. It would be absolutely vital to have clear and long term transition arrangements in place, given that the market will take time to migrate liquidity to new rates. It is important to note that adherence to an ISDA Protocol is entirely voluntary, and market participants will only adhere if they perceive that it is in their interest to do so. For the Protocol to be as effective as possible a significant period of time is required so that as many market participants as possible can participate, and can have the opportunity to do so as they see liquidity migrating to the new rate sources. Without such transition arrangements, the ensuing market disruption could be potentially unmanageable.

We have mentioned **the risk of claims of contractual frustration** a number of times, and now turn to cover this in more detail in the context of OTC derivatives portfolios covered by English law-governed ISDA Master Agreements. As suggested above, there is likely to be something of a continuum from minor changes that could most likely still be regarded as falling within the existing definitions of the floating rates, through to more significant changes that could lead some market participants to claim under doctrines of contractual frustration or otherwise, that the nature of their contract had changed fundamentally from what they had originally intended. It is certainly unclear at which point one becomes the other, and we hope that changes could be managed in such a way that it is not tested.

Under the **English law** doctrine of frustration a contract may be discharged if broadly speaking, after its formation supervening events occur which have the effect of either (i) frustrating the contract's commercial object or purpose or (ii) making its performance impossible. It is unclear whether major changes to a rate, or its discontinuation, would be grounds for a valid claim of frustration or under some other doctrine but it will be clear those changes to or discontinuation of a rate potentially brings us into this territory and indeed some of the decided cases touch on these very points. As mentioned above, the 2006 ISDA Definitions provide a fallback to Reference Bank polling in the event that a given rate disappears from a page, so to a degree direct contractual provision has been made for the eventuality of a rate's discontinuation. On the other hand, as noted above, that fallback might not prove workable in practice. We believe that there is a risk that discontinuation of a rate or changes other than those that are clearly economically immaterial to its calculation, could give grounds for claims of contractual frustration. We urge the authorities to bear this in mind as they contemplate the future of a benchmark, both in its current form or some other, in order to avoid the major market disruption that the uncertainty of any such claims would cause.

Additional analysis would be required to assess the risk of claims under doctrines such as contractual frustration (or any local equivalent) in respect of ISDA Master Agreements governed by anything **other than English law**. We understand that concerns similar to those noted above could arise under New York law. New York or English law is the governing law for most OTC derivatives contracts.

Reporting

Moreover, there should be alignment with existing regulatory initiatives. Particularly, if transactions are to be reported, then existing reporting databases, systems and reporting routes should be leveraged. Regulatory reporting of benchmark submissions should also leverage existing trade capture and reporting routes already used by many market participants for their existing trading and/ or regulatory reporting activities. It would be highly disadvantageous to require another regulatory reporting system from market participants when in most cases they already submit to more than one. Appropriate time should be allowed for introduction of changes.