ISDA Safe, Efficient Markets

IBOR Fallbacks for 2006 ISDA Definitions – FAQs

1. How were the fallback rates determined?

ISDA determined, after consultation with its members, other industry participants, regulators and the Financial Stability Board (FSB) Official Sector Steering Group (OSSG), that for purposes of ISDA's work, the fallback rate for each of the interbank offered rates (IBORs)[1] will be the overnight risk-free rate (RFR) identified by the relevant public-private sector RFR working group or, if no such group exists, relevant regulators.

The relevant public-private sector RFR working groups are also preparing transition plans driven by both regulators and market participants to facilitate transition from the IBOR to the RFR. It is expected that, among other things, these plans will result in increased liquidity in transactions referencing the identified rates.

With respect to the IBORs covered by this consultation:

- The Japanese Study Group on Risk-Free Reference Rates identified TONA as the alternative risk-free rate for TIBOR, JPY LIBOR and Euroyen TIBOR, so TONA will be the fallback rate for TIBOR, JPY LIBOR and Euroyen TIBOR;
- The Working Group on Sterling Risk-Free Reference Rates recommended SONIA as the alternative risk-free rate for GBP LIBOR, so SONIA will be the fallback rate for GBP LIBOR;
- The National Working Group on Swiss Franc Reference Rates recommended SARON as the alternative risk-free rate for CHF LIBOR, so SARON will be the fallback rate for CHF LIBOR; and
- ISDA liaised with the Reserve Bank of Australia to identify the RBA cash rate as the fallback rate for BBSW.

With respect to IBORs that subsequent supplemental consultations will cover:

- The US Alternative Reference Rates Committee identified SOFR as the alternative risk-free rate for USD LIBOR, so SOFR will be the fallback rate for USD LIBOR;

[1] This consultation covers GBP LIBOR, CHF LIBOR, JPY LIBOR, TIBOR, Euroyen TIBOR and BBSW. ISDA anticipates that it will issue supplemental consultations regarding USD LIBOR, EUR LIBOR, EURIBOR and HIBOR. The FSB OSSG may ask ISDA to consider additional IBORs, including potentially the Canadian Dollar Offered Rate (CDOR).

- The Working Group on Euro Risk-Free Rates is due to recommend an alternative risk-free rate for the euro area in the second half of 2018, so that will be the fallback rate for EURIBOR and EUR LIBOR; and

- ISDA liaised with the Hong Kong Monetary Authority to identify HONIA as the fallback rate for HIBOR.

2. How were the triggers for permanent cessation determined?

ISDA, after consultation with its members, other industry participants, regulators and the FSB OSSG, determined that the triggers for permanent cessation must be objective, transparent and based on publicly available information. It would be very problematic if only some market participants believed that an event triggered the fallbacks. Therefore, the triggers require a public statement or publication of information by the administrator for the relevant IBOR, the relevant central bank or someone with authority over the administrator (e.g., the regulatory supervisor for the administrator).

3. Who can respond to the consultation?

The consultation is open to *all market participants*. It is in no way limited to ISDA members. ISDA strongly encourages users of both derivatives and users of financial instruments that are hedged by derivatives to respond. We also strongly encourage users of IBORs that are not covered by this consultation, but that will be covered by subsequent supplemental consultations (i.e., USD LIBOR, EUR LIBOR, EURIBOR, HIBOR), to respond with their preliminary views.

If a trade association, law firm, consultancy firm or similar organization responds on behalf of multiple market participants, they should name the market participants that specifically contributed to the response, and ensure that the response does not conflict with separate responses from any of the specified market participants. Trade associations, law firms and similar organizations should also encourage their members and clients to respond to the consultation directly.

4. How will ISDA select the approach for calculating the "adjusted RFR" and "spread adjustment" based on consultation responses?

ISDA will select the approach based on the responses received from all market participants. ISDA will consider the full range of views expressed by respondents (including non-ISDA members) and will make a determination based on the consensus among respondents and what is best for the market overall. The ISDA Board Benchmark Committee, which is comprised of 12 ISDA board members from a diverse group of institutions, will have the ultimate responsibility for this determination.

Among other things, ISDA will consider the following:

- The percentage of individual market participants that prefer the approach.

- Whether a segment of market participants have a consensus view, or a meaningful number of all market participants indicate, that they would not be able to transact using definitions that incorporate fallbacks based on such approach.
- Whether the approach would result in transactions that could not be cleared by major derivatives CCPs, either once the fallbacks are incorporated in transactions or once the fallbacks are applied.
- Whether selecting the approach could expose ISDA to the risk of litigation or regulatory action.
- Advice and guidance from ISDA's external advisors.

ISDA will publish an explanation of how it selected the approach based on the responses received. ISDA will also publish an aggregated and anonymized summary of responses received.

5. **Will the same approach for calculating the "adjusted RFR" and "spread adjustment" apply to all covered IBORs?**

The consultation contemplates the possibility of implementing different approaches for different IBORs but invites feedback on this point. Respondents should indicate whether their responses apply to all of the IBORs covered by the consultation or whether their preferences differ across the IBORs. ISDA also invites respondents to provide feedback on whether they generally think that consistency in approaches across IBORs is important or whether they think that differences among the IBORs and differences among the RFRs that will be the fallback rates may warrant different approaches.

6. **The US Alternative Reference Rates Committee has identified SOFR as the alternative for USD LIBOR and SOFR trading recently commenced. Why does the consultation not cover SOFR?**

Trading in products referencing SOFR commenced very recently. ISDA determined that market participants would be better able to provide preferences on the "adjusted RFR" and "spread adjustment" for SOFR as the USD LIBOR fallback rate once they have more information about how SOFR trades in the market.

7. **When will ISDA launch the supplemental consultations for USD LIBOR, EUR LIBOR and EURIBOR?**

The consultation for USD LIBOR will launch once there is additional liquidity and trading in products referencing SOFR.

The consultation for EUR LIBOR and EURIBOR will launch once the alternative RFR for the Eurozone is identified (as that rate will be the fallback rate for these IBORs) and there is liquidity and trading in products referencing that rate.

The exact timing for these consultations is uncertain but will also depend somewhat on the preliminary feedback ISDA receives in response to this consultation and the feedback

ISDA receives regarding whether market participants believe that consistency in approaches across IBORs is important.

8. Will the same fallback rate apply to all tenors of a particular IBOR?

Yes, the same fallback rate will apply to all tenors of a particular IBOR even though the fallback rates are overnight rates and the IBORs have a variety of terms. However, to account for the move from a "term" rate (i.e., the IBOR) to an overnight rate (i.e., the overnight RFR), the fallbacks ISDA implements will apply an adjustment to the relevant overnight RFR so that it is more comparable to the relevant IBOR. The consultation refers to the adjusted rate as the "adjusted RFR" and asks for feedback on the best approach for calculating the adjusted RFR.

9. Why do the choices for calculating the "adjusted RFR" not include a forward-looking term rate?

For the IBORs covered by this consultation, the FSB OSSG's message was that ISDA should develop fallbacks that could be used in the absence of suitable term rates and, in doing so, should focus on calculations based on the overnight RFRs. The FSB OSSG recently discussed its position in "Interest rate benchmark reform – overnight risk-free rates and term rates", available at http://www.fsb.org/wp-content/uploads/P120718.pdf.

Consistent with this position, the Working Group on Sterling Risk-Free Reference Rates (Sterling RFR WG) indicated in its December 12th, 2017 minutes that there should be no need for forward-looking term rates to be used for cleared and listed derivatives and, over time, a reduced need for term rates in bilateral swap markets.[2] While USD LIBOR is not directly in scope for this consultation, we note that the US Alternative Reference Rates Committee (ARRC) has also indicated that derivatives should reference the overnight RFRs and that forward-looking term rates are intended for use in cash products and would not be appropriate for most derivatives.

The fallbacks that ISDA is implementing will be for derivatives (as opposed to cash products) and therefore, unlike the forward-looking term rates separately under consideration by the Sterling RFR WG and the ARRC, the approaches under consideration are based on the overnight RFRs.

10. Will the "spread adjustment" change as a result of changes in the interbank market after the relevant IBOR ceases publication?

No. Although ISDA considered ways to calculate a "dynamic" spread adjustment, market participants and regulators expressed concerns regarding the long-term viability of such an approach. ISDA therefore proposes a methodology for determining a "static" spread that is set at the time of the trigger (although, under two of the approaches, while

[2] https://www.bankofengland.co.uk/-/media/boe/files/minutes/2017/rfr-dec-2017.pdf?la=en&hash=57DF04D160219EAC3FB6E99770278285D797B8CB, paragraph 12. A consultation on forward looking term rates has separately been published in the UK (https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/consultation-on-term-sonia-reference-rates.pdf) and the Sterling RFR WG will provide a recommendation once consultation responses are assessed.

the spread would be set and known for each day going forward at the time of trigger, it would not be the same number each day).

11. Why are certain approaches not compatible with each other?

As a technical matter, it may be possible to implement any pair of adjusted RFR and spread adjustment. However, after analysis and in consultation with its external advisors, ISDA determined that it made the most sense to eliminate three pairs from consideration. The chart below sets forth the pairs that are under consideration in the consultation and highlights the three pairs that ISDA determined were not compatible.

	Forward Approach	Historical Mean/Median Approach	Spot-Spread Approach
Spot Overnight Rate	Not compatible		
Convexity-adjusted Overnight Rate	Not compatible		
Compounded Setting in Arrears Rate			Not compatible
Compounded Setting in Advance Rate			

12. Can respondents suggest technical adjustments, improvements and/or clarifications with respect to the approaches?

Yes, while the consultation requests feedback on specific aspects of the approaches (e.g., length of the look-back period for the historical mean/median approach to the spread adjustment), the consultation also asks for feedback generally and ISDA welcomes any and all feedback from market participants. ISDA encourages market participants to suggest technical adjustments, improvements and/or clarifications (e.g., with respect to cut-off dates and payment mechanisms that could apply if the fallbacks are triggered). To ensure that all market participants have a chance to review and provide feedback on any adjustments that ISDA makes as a result of this consultation or otherwise as necessary for a vendor to implement the selected approach, ISDA will publish the final approach or approaches for review and comment before implementing any amendments to its interest rate definitions.

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13. When will ISDA implement the fallbacks?

For the IBORs covered by this consultation, ISDA hopes to implement fallbacks through amendments to the 2006 ISDA Definitions[3] during the first half of 2019. ISDA contemplates launching a protocol for inclusion of the amended definitions (i.e., the definitions with fallbacks) in existing transactions[4] at the same time. Timing for implementation of fallbacks for IBORs to be covered by supplemental consultations is less certain but ISDA hopes to be able to align timing to the maximum extent possible.

14. Can I watch the July webinar?

Yes, the July webinar is available on the ISDA website at https://78449.choruscall.com/dataconf/productusers/isda/mediaframe/25581/indexr.html. All market participants may watch it at their convenience.

15. Where can I find information about the September webinar?

Like the July webinar, ISDA will record the September webinar and publish it on the ISDA website so that market participants may view it at their convenience. The September webinar will be available sometime before September 14th, 2018. ISDA will send an email notification when it publishes the webinar.

16. How can I submit additional questions regarding the consultation?

Please submit additional questions to FallbackConsult@isda.org.

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[3] A definitional booklet published by ISDA to provide a basic framework for the documentation of privately negotiated interest rate and currency derivative transactions. The 2006 ISDA Definitions are intended for use in confirmations of individual transactions governed by ISDA Master Agreements and are also referenced by CCPs that clear interest rate and currency derivative transactions. From time to time, ISDA publishes 'Supplements' to amend the 2006 ISDA Definitions on its website. The amendments made by these Supplements apply to transactions referencing the 2006 ISDA Definitions that are entered into on or after the date the relevant Supplement is published.

[4] Amendments to ISDA's definitions, including the 2006 ISDA Definitions, would only apply to transactions referencing the definitions that are entered into on or after the date of the amendments.