NEWS RELEASE
For Immediate Release

ISDA Publishes Consultation on Benchmark Fallbacks

NEW YORK, July 12, 2018 – The International Swaps and Derivatives Association, Inc. (ISDA) has launched a market-wide consultation on technical issues related to new benchmark fallbacks for derivatives contracts that reference certain interbank offered rates (IBORs). The consultation sets out options for adjustments that would apply to the fallback rate in the event an IBOR is permanently discontinued.

ISDA has been leading an industry effort to implement robust fallbacks for derivatives contracts referenced to certain IBORs since 2016, at the request of the Financial Stability Board's Official Sector Steering Group (FSB OSSG). Following consultation with industry participants, regulators and the FSB OSSG, the fallback rates will be the risk-free rates (RFRs) identified as alternatives for the relevant IBORs as part of global benchmark reform efforts. These fallbacks will be included in the ISDA definitions for interest rate derivatives and will apply to new IBOR trades. ISDA will also publish a protocol to allow participants to include the fallbacks within legacy IBOR contracts, if they choose to.

The consultation sets out possible options for adjustments to the RFRs to ensure legacy derivatives contracts referenced to an IBOR continue to function as close as possible to what was intended after a fallback takes effect. These adjustments reflect the fact that the IBORs are currently available in multiple tenors – for example, one, three, six and 12 months – but the RFRs are overnight rates. The IBORs also incorporate a bank credit risk premium and a variety of other factors (such as liquidity and fluctuations in supply and demand), while RFRs do not.

"Having robust fallbacks for derivatives contracts that reference an IBOR is critical for the stability of the financial system. If an IBOR permanently ceases to exist, it is vital that market participants have certainty that their existing IBOR contracts will fall back to a robust and clearly defined reference rate. But it's also important that the switch to the fallback rate occurs with the minimum amount of disruption, which is why an adjustment to the RFR is necessary," said Scott O'Malia, ISDA's Chief Executive.

The consultation sets out four options to account for the move from a term rate to an overnight rate: a spot overnight rate; a convexity adjusted overnight rate; a compounded setting in arrears rate; and a compound setting in advance rate. Three options are also proposed to calculate a spread adjustment: a forward approach; a historical mean/median approach; and a spot-spread approach. In each case, the spread adjustment will be fixed at the point the fallback is triggered.

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The consultation will run for three months and is open to all market participants. The responses to the consultation will determine the selected approach, and ISDA will then work with an independent third-party vendor selected via an RFP process to build a system that will provide public dissemination of the adjustments. ISDA will publish the final approach for review and comment before any changes are made to its standard documentation.

The consultation is available here.

Background

- In July 2016, the FSB OSSG asked ISDA to participate in work to enhance the robustness of derivatives contracts referencing widely used benchmarks. The FSB's objectives were for market participants to understand the fallback arrangements that would apply if key IBORs were permanently discontinued, and for the arrangements to be robust enough to prevent potential serious market disruption.
- If an IBOR is not available (including if it is permanently discontinued), current fallbacks under the 2006 ISDA Definitions require the calculation agent to obtain quotes from major dealers in the relevant interdealer market. If an IBOR has been permanently discontinued, it is likely that major dealers would be unwilling and/or unable to give such quotes. Even if quotes were available in the near-term after a permanent discontinuation, it is unlikely they would be available for each future reset date over the remaining tenor of long-dated contracts. It is also likely that quotes could vary materially across the market.
- Following consultation with the industry, regulators and the FSB, it was determined that the fallbacks will be the RFRs identified by the relevant public-/private sector working groups as an alternative to the IBORs.
- These public-/private-sector working groups are now working to encourage transition from the IBORs to the identified RFRs. Working groups have been set up in several jurisdictions, including the UK (the Working Group on Sterling Risk-Free Reference Rates), US (the ARRC), Europe (the Working Group on Euro Risk-Free Rates), Switzerland (the National Working Group on Swiss Franc Reference Rates) and Japan (the Japanese Study Group on Risk Free Reference Rates).
- The ISDA consultation covers sterling LIBOR, Swiss franc LIBOR, yen LIBOR, TIBOR, euroyen TIBOR and the Australian Bank Bill Swap Rate.

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About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 900 member institutions from 68 countries. These members comprise a broad range of 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, such as exchanges, intermediaries, clearing houses 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 website: www.isda.org. Follow us on Twitter @ISDA.