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ISDA Publishes Final Results of Benchmark Fallbacks Consultation

NEW YORK, December 20, 2018 – The International Swaps and Derivatives Association, Inc. (ISDA) has today published a report summarizing the final results of a consultation on technical issues related to new benchmark fallbacks for derivatives contracts that reference certain interbank offered rates (IBORs).

The report, *Anonymized Narrative Summary of Responses to the ISDA Consultation on Term Fixings and Spread Adjustment Methodologies*, was prepared for ISDA by The Brattle Group and confirms the preliminary findings published by ISDA at the end of November. The consultation, which was launched in July, covered the proposed methodologies for certain adjustments that would apply to the fallback rate in the event an IBOR is permanently discontinued.

The report highlighted that the overwhelming majority of respondents preferred the 'compounded setting in arrears rate' for the adjusted risk-free rate (RFR), and a significant majority across different types of market participants preferred the 'historical mean/median approach' for the spread adjustment. The majority of respondents preferred to use the same adjusted RFR and spread adjustment across all benchmarks covered by the consultation and potentially other benchmarks (such as US dollar LIBOR, euro LIBOR and EURIBOR). ISDA expects to launch a supplemental consultation in early 2019 to gather feedback regarding US dollar LIBOR and potentially other benchmarks not covered by the recent consultation.

In accordance with these results, ISDA will proceed with developing fallbacks for inclusion in its standard definitions based on the compounded setting in arrears rate and the historical mean/median approach to the spread adjustment for all of the benchmarks covered by the consultation. In the coming months, ISDA and its independent advisors will work to determine the appropriate parameters for the historical mean/median approach to the spread adjustment (including, for example, whether to use a mean or median calculation and the length of the historical lookback period).

As part of this work, ISDA will publish the results of sensitivity analyses to provide all market participants with a better understanding of the range of parameters in the historical mean/median approach. ISDA and its independent advisors will also work to address technical issues that need to be resolved to finalize the precise formula for calculating the spread adjustment and the compounded setting in arrears rate.

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Before implementing fallbacks in its standard definitions, ISDA expects to solicit additional feedback from market participants on the final parameters of the historical mean/median approach to the spread adjustment.

Background

- 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). 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 industry participants, regulators and the FSB OSSG, the fallback rates will be the 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 do so.

- The adjustments considered in the recent consultation will apply to the RFRs if the fallbacks take effect for the benchmarks covered by that consultation. These adjustments reflect the fact that the IBORs are 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. The spread adjustment will vary based on the tenor of the relevant IBOR (although all of the spread adjustments will be based on the same methodology applied to data for the relevant tenor). The adjustments to the RFRs are intended to ensure legacy derivatives contracts referenced to an IBOR continue to function as close as possible to what was intended if a fallback takes effect.

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About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 70 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.