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Understanding IBOR Benchmark Fallbacks

1: What is a benchmark fallback?

Benchmark fallbacks are replacement rates that would apply to derivatives trades referencing a particular benchmark. These would take effect if the relevant benchmark becomes unavailable while market participants continue to have exposure to that rate. Specific fallback rates are set out in the 2006 ISDA Definitions. ISDA is working on new robust fallbacks that would apply in the event of a permanent cessation of a key interbank offered rate (IBOR).

2: Why are changes to fallbacks necessary?

Current fallbacks under the 2006 ISDA Definitions typically require the counterparty that is 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. It is also likely that quotes could vary materially across the market.

With respect to LIBOR, the UK Financial Conduct Authority (FCA) has stated that it will not compel or persuade banks to make LIBOR submissions after the end of 2021, raising the likelihood that LIBOR will cease to exist after that date.

3: What rates have been chosen as fallbacks for the IBORs?

It was determined that the fallbacks will be adjusted versions of the risk-free rates (RFRs) identified by public-/private-sector working groups in each jurisdiction as alternatives to the IBORs. These are AONIA (Australian dollar), CORRA (Canadian dollar), €STR (euro), HONIA (Hong Kong dollar), SARON (Swiss franc), SOFR (US dollar), SONIA (sterling) and TONA (yen) (see Table)[1].

4: What is a fallback adjustment?

There are inherent structural differences between the IBORs and RFRs. IBORs are available in multiple tenors while RFRs are overnight rates. The IBORs also incorporate a bank credit risk premium and other factors. Adjustments are therefore needed to the RFRs to ensure contracts originally negotiated to reference an IBOR continue to meet the original objectives of the counterparties to the maximum extent possible once a fallback takes effect. Following a series of industry consultations on the adjustment methodologies, the RFRs will be compounded over the relevant IBOR period and a spread adjustment will be added to the compounded rate. The spread adjustment will be based on the median over a five-year period of the historical differences between the IBOR in the relevant tenor and the relevant RFR compounded over each corresponding period.

5: Under what circumstances will the new fallbacks come into effect?

The adjusted RFR in the relevant currency would apply as a fallback following a permanent cessation of the IBOR in that currency. For derivatives that reference LIBOR only, the adjusted RFR in the relevant currency would also apply as a fallback following a determination by the FCA that LIBOR in that currency is no longer representative of its underlying market, even if it continues to be published.

6: How can I adopt the new fallbacks?

ISDA will publish a supplement amending the 2006 ISDA Definitions to incorporate the new fallbacks. These changes will automatically apply to cleared and non-cleared derivatives referencing the 2006 ISDA Definitions that are executed on or after the date the supplement comes into effect. A protocol will also be published that will enable market participants to choose to incorporate the revisions into their legacy non-cleared derivatives trades with counterparties that also opt to adhere to the protocol. Parties could also agree to incorporate the new fallbacks by bilaterally amending their legacy non-cleared contracts. Clearing houses have indicated they will use the powers in their rule books to implement the fallbacks in all of their legacy cleared derivatives transactions as of the effective date of the updates

1 ISDA is also updating the 2006 ISDA Definitions to provide fallbacks for certain interest rate benchmarks that use US dollar LIBOR as an input, so contracts referencing those benchmarks have robust fallbacks in the event of a permanent cessation of US dollar LIBOR

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7: What is an ISDA protocol?

A protocol is a multilateral contractual amendment mechanism that is used to make standard amendments to ISDA documentation among adhering counterparties. Protocols provide an efficient way of implementing industry standard contractual changes to legacy trades with a large number of counterparties, avoiding the need to bilaterally negotiate the same amendments with each party individually.

8: Where can I find the fallback rates?

Bloomberg will publish the adjustments and all-in fallback rates via a variety of distribution platforms. As a result, counterparties will be able to access the fallback rates on a screen in the same way they access the IBORs today (although the fallback rates will be available at the end of each period instead of the beginning). More information is available here: bloom.bg/3byXgm5

9: Can I use fallbacks to transition from the IBORs?

Fallbacks are not intended to be a primary means of moving from IBORs to RFRs. Once the fallbacks are in place, it is recommended that market participants focus on voluntary transition before the cessation of any key IBOR. Moving away from key IBORs voluntarily by amending or closing out contracts that reference those rates allows counterparties to tailor their strategies to their specific portfolios, and could allow firms to negotiate terms that avoid the adjustment mechanisms for fallbacks.

LIBOR Currency	IBOR	Administrator	Alternative RFR	Alternative RFR Administrator	Public-/Private-sector Working Group
Australian Dollar	Bank Bill Swap Rate (BBSW)	Australian Securities Exchange	Reserve Bank of Australia Interbank Overnight Cash Rate (AONIA)	Reserve Bank of Australia	
Canadian Dollar	Canadian Dollar Offered Rate (CDOR)	Refinitiv	Canadian Overnight Repo Rate Average (CORRA)	Refinitiv	Canadian Alternative Reference Rate Working Group
Swiss Franc	LIBOR	ICE Benchmark Administration (IBA)	Swiss Average Rate Overnight (SARON)	SIX Swiss Exchange	National Working Group on Swiss Franc Reference Rates
Euro	LIBOR Euro Interbank Offered Rate (EURIBOR)	IBA European Money Markets Institute	Euro Short-term Rate (€STR)	European Central Bank	Working Group on Euro Risk-free Rates
Sterling	LIBOR	IBA	Sterling Overnight Index Average (SONIA)	Bank of England	Working Group on Sterling Risk-free Reference Rates
Hong Kong Dollar	Hong Kong Interbank Offered Rate (HIBOR)	Treasury Markets Association (TMA)	Hong Kong Dollar Overnight Index Average (HONIA)	TMA	Working Group on Alternative Reference Rates under the TMA
Yen	LIBOR Tokyo Interbank Offered Rate (TIBOR) Euroyen TIBOR	IBA Japanese Bankers Association TIBOR Administrator (JBATA) JBATA	Tokyo Overnight Average Rate (TONA)	Bank of Japan	Cross-industry Committee on Japanese Yen Interest Rate Benchmarks
US Dollar	LIBOR	IBA	Secured Overnight Financing Rate (SOFR)	Federal Reserve Bank of New York	Alternative Reference Rates Committee

More information on the new benchmark fallbacks for derivatives is available on the ISDA website: **bit.ly/2y3R47N**