ISDA Safe, Efficient Markets

May 16, 2019

Consultation on Pre-Cessation Issues for LIBOR and Certain Other Interbank Offered Rates (IBORs)

Executive summary

- ISDA intends to amend its standard documentation to implement fallback reference rates ("fallbacks") for certain key IBORs, including LIBOR, to protect against the risk that those IBORs could cease at some point in the future. Specifically, ISDA intends to amend and restate the 'rate options' in the 2006 ISDA Definitions to ensure that, in the event certain IBORs cease, the fallbacks will apply to derivative transactions that are entered into on or after the effective date of the amendments and incorporate the 2006 ISDA Definitions. ISDA also expects to publish a protocol to facilitate inclusion of the fallbacks in pre-existing derivative transactions which incorporate the 2006 ISDA Definitions, the 2000 ISDA Definitions or which otherwise reference a relevant IBOR in the related ISDA master agreement or ISDA credit support documentation.
- Recent statements by the UK Financial Conduct Authority (FCA) suggest that market participants may wish to consider including in their LIBOR contracts "pre-cessation" fallback triggers based on an announcement by the FCA that LIBOR is no longer representative, in addition to fallback triggers based on permanent cessation.[1]
- Certain public-private sector RFR working groups, such as the Alternative Reference Rates Committee (ARRC) in the United States, have consulted on and published template fallback language for new cash products which includes non-representative "pre-cessation" triggers.
- In March 2019, the Financial Stability Board (FSB) Official Sector Steering Group (OSSG) co-chairs wrote to ISDA encouraging ISDA to seek market opinion on the events that should trigger a move to a spread-adjusted fallback rate for LIBOR.[2]

[1] https://www.fca.org.uk/news/speeches/libor-transition-and-contractual-fallbacks.

[2] http://www.fsb.org/wp-content/uploads/P150319.pdf.

- **This consultation seeks further input on the preferred approach for addressing pre-cessation issues in derivatives that reference LIBOR and certain other IBORs ('Covered IBORs')[3] that are critical benchmarks within the meaning of the EU Benchmarks Regulation[4], including in the context of a regulator's statement that the relevant Covered IBOR is no longer representative.[5]**
- **ISDA will use the responses to this consultation to determine what protocols or other documentation solutions would be most useful and appropriate for derivatives market participants to use in addressing pre-cessation issues.**

Background

Amendments to ISDA documentation to include new permanent cessation triggers and fallbacks ('ISDA IBOR Fallbacks')

The FSB OSSG asked ISDA to participate in work to enhance the robustness of derivative contracts referencing widely used benchmarks. In September 2016, ISDA agreed to convene discussions regarding derivative contract robustness including, specifically, selection of fallbacks for key benchmarks. Consequently, ISDA plans to amend certain 'rate options' in the 2006 ISDA Definitions to include fallbacks that would apply upon the *permanent discontinuation* of certain key IBORs. An IBOR could be permanently discontinued for a variety of reasons, including but not limited to issues with the administrator, unavailability of submissions from panel banks or regulatory concerns. The fallbacks that ISDA plans to implement in the 2006 ISDA Definitions will apply upon any permanent discontinuation, regardless of its cause.

Permanent cessation (or an 'index cessation event') will be defined to include:

(i) a public statement or publication of information by or on behalf of the administrator of [the relevant IBOR] announcing that it has ceased or will cease to provide [the relevant IBOR] permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide [the relevant IBOR]; or

[3] This consultation does not cover TIBOR, Euroyen TIBOR, BBSW, HIBOR or CDOR. The consultation covers SOR only insofar as to consider if the SOR fallback for a USD LIBOR "index cessation event" – which is separately being consulted upon currently – should also apply in the event of a USD LIBOR pre-cessation trigger.

[4] Art. 3(25) of Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

[5] We note that, as with the cessation triggers, clarity regarding the substance and regulatory authority for such a statement will be critical in drafting any triggers or similar contractual provisions.

(ii) a public statement or publication of information by the regulatory supervisor for the administrator of [the relevant IBOR], the central bank for the currency of [the relevant IBOR], an insolvency official with jurisdiction over the administrator for [the relevant IBOR], a resolution authority with jurisdiction over the administrator for the [the relevant IBOR] or a court or an entity with similar insolvency or resolution authority over the administrator for [the relevant IBOR], which states that the administrator of [the relevant IBOR] has ceased or will cease to provide [the relevant IBOR] permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide [the relevant IBOR].

Note that the fallbacks will not apply until the actual discontinuation of the relevant IBOR (if that is after the announcement date).

As it has done from time to time, ISDA intends to amend the 2006 ISDA Definitions by publishing a 'Supplement' (or 'Supplements') to the 2006 ISDA Definitions. Upon publication of the Supplement for the relevant IBOR, all transactions incorporating the 2006 ISDA Definitions that are entered into on or after the effective date of the Supplement (*i.e.,* the date that the 2006 ISDA Definitions are amended) will include the amended rate option (*i.e.,* the rate option with the permanent cessation trigger and related fallback).

The amendments to the rate options in Section 7.1 of the 2006 ISDA Definitions[6] for any such IBORs will take the form of:

(i) a statement identifying the objective triggers that would activate the selected fallbacks; and

(ii) a description of the fallback that would apply upon the occurrence of that trigger, which will be the relevant risk-free rate (RFR), adjusted using methodologies to account for (a) the fact that the RFR is an overnight rate and (b) the various premia included within the IBOR.

ISDA has determined, after consultation with industry participants, regulators and the FSB OSSG, that for a given IBOR below, the fallback rate will be the overnight RFR identified by the relevant public-private sector RFR working group as an alternative to that IBOR or, if no such RFR working group exists, the RFR identified by relevant regulators. These include:

[6] ISDA is undertaking a separate project to publish a new interest rate definitions booklet (the 2019 ISDA Interest Rate Derivatives Definitions). ISDA plans to amend the relevant rate options in the 2006 ISDA Definitions as it expects market participants will continue to use those definitions for a period of time before adopting the new booklet. The relevant IBOR rate options in the 2019 ISDA Interest Rate Derivatives Definitions will contain the same index cessation event trigger and the same fallbacks to the adjusted RFR plus spread as those included in the amendments to the 2006 ISDA Definitions.

Relevant IBOR and corresponding rate options in 2006 ISDA Definitions		Fallback rate
GBP LIBOR	GBP-LIBOR-BBA GBP-LIBOR-BBA-Bloomberg	SONIA
CHF LIBOR	CHF-LIBOR-BBA CHF-LIBOR-BBA-Bloomberg	SARON
JPY LIBOR	JPY-LIBOR-FRASETT JPY-LIBOR-BBA JPY-LIBOR-BBA-Bloomberg	TONA[7]
TIBOR	JPY-TIBOR-TIBM JPY-TIBOR-17096 JPY-TIBOR-17097 JPY-TIBOR-TIBM (All Banks)-Bloomberg	TONA
Euroyen TIBOR	JPY-TIBOR-ZTIBOR	TONA
BBSW	AUD-BBR-AUBBSW AUD-BBR-BBSW AUD-BBR-BBSW-Bloomberg	RBA Cash Rate (AONIA)
USD LIBOR	USD-LIBOR-BBA USD-LIBOR-BBA-Bloomberg	SOFR

[7] The fallbacks which ISDA implements will be based on the RFR. However, ISDA does not exclude the possibility of a market participant electing to use TIBOR as the fallback for JPY LIBOR.

EUR LIBOR	EUR-LIBOR-BBA EUR-LIBOR-BBA-Bloomberg	€STR
EURIBOR	EUR-EURIBOR-Reuters	€STR
CDOR	CAD-BA-CDOR CAD-BA-CDOR-Bloomberg	CORRA[8]
HIBOR	HKD-HIBOR-HKAB HKD-HIBOR-HKAB-Bloomberg	HONIA

After consultation with industry participants with respect to GBP LIBOR/SONIA, CHF LIBOR/SARON, JPY LIBOR/TONA, TIBOR/TONA, Euroyen TIBOR/TONA and BBSW/Cash Rate, ISDA has determined that the adjustment to those RFRs to account for (i) the fact that the RFR is an overnight rate, will be calculated using the 'compounded setting in arrears rate' and (ii) for the various premia included within the IBOR, will be calculated using the 'historical mean/median approach'.[9] ISDA is separately consulting on the preferred methodologies in respect of fallbacks for USD LIBOR, CDOR and HIBOR and certain aspects of fallbacks for derivatives referencing SOR,[10] and will also consult on the preferred methodologies in respect of fallbacks for EUR LIBOR and EURIBOR.

Transactions entered into prior to the effective date of the Supplement (so called 'legacy derivative contracts') will continue to be based on the 2006 ISDA Definitions as the 2006 ISDA Definitions existed before they were amended pursuant to the Supplement, and therefore will not

[8] The Canadian Alternative Reference Rate Working Group (CARR) recommended CORRA as the preferred RFR for the Canadian dollar. CARR recently consulted on recommendations to enhance the calculation methodology for CORRA. Please see https://www.bankofcanada.ca/wp-content/uploads/2019/02/consultation-paper-proposed-enhancements-to-corra.pdf and https://www.bankofcanada.ca/markets/canadian-alternative-reference-rate-working-group/ for more details.

[9] The preliminary results of the consultation on GBP LIBOR/SONIA, CHF LIBOR/SARON, JPY LIBOR/TONA, TIBOR/TONA, Euroyen TIBOR/TONA and BBSW/Cash Rate can be found here: http://assets.isda.org/media/736bd0ed/1f0db5ee-pdf/ and the Anonymized Summary of Responses can be found here: http://assets.isda.org/media/04d213b6/db0b0fd7-pdf/.

[10] https://www.isda.org/2019/05/16/may-2019-benchmark-fallbacks-consultations

include the amended rate option with the index cessation event trigger and fallback. However, ISDA also expects to publish a protocol (or protocols) to facilitate multilateral amendments to include the amended rate options, and therefore the index cessation event trigger and related fallbacks, in legacy derivative contracts. By adhering to the protocol, market participants would agree that their legacy derivative contracts *with all other adherents* will include the amended rate option for the relevant IBOR and will therefore include the same event triggers and fallbacks that will be included in new transactions that incorporate the 2006 ISDA Definitions. As always, any such protocol will be voluntary and will only amend contracts between two adhering parties (*i.e.*, it will not amend contracts between an adhering party and a non-adhering party or between two non-adhering parties). However, market participants and their regulators may view adherence to the protocol alongside use of the ISDA Benchmarks Supplement[11], as facilitating or enhancing compliance with regulatory obligations or expectations, such as those under Article 28(2) of the EU Benchmarks Regulation, to produce and maintain robust written plans setting out the actions that they would take in the event that a benchmark materially changes or ceases to be provided and to reflect such plans in the contractual relationship with clients. This may particularly be the case if the regulatory obligation includes a requirement that, where feasible and appropriate, such plans should nominate one or several alternative benchmarks that could be referenced to substitute the benchmark no longer provided.[12]

CCPs that clear over-the-counter (OTC) interest rate derivatives generally incorporate the 2006 ISDA Definitions either by incorporation by reference or by reproducing the applicable portions in their respective rulebooks. Therefore, once the relevant rate options are amended to include triggers and fallbacks, the triggers and fallbacks would generally apply to OTC derivatives subsequently cleared at such CCPs. LCH and CME have confirmed that they may use the discretion they have in their rulebooks to implement the amended rate options (i.e. the rate options with the index cessation event trigger and fallbacks) in existing transactions that they have cleared.[13] Similarly, CME and LCH have each communicated to ISDA and regulators that, subject to the detail and feedback on this consultation, they believe that market efficiencies

[11] See https://www.isda.org/protocol/isda-2018-benchmarks-supplement-protocol/ for the ISDA 2018 Benchmarks Supplement Protocol and https://www.isda.org/book/isda-benchmarks-supplement/ for the ISDA Benchmarks Supplement. ISDA has provided additional clarity on the interaction between the ISDA Benchmarks Supplement and the IBOR Fallbacks in FAQs on its website and expects to update these FAQs in light of any developments in relation to this consultation.

[12] See Article 28(2) of the EU Benchmarks Regulation. See also ESMA's Questions and Answers on the EU Benchmarks Regulation and particularly Q&A 8.1 (https://www.esma.europa.eu/sites/default/files/library/esma70-145-114_qas_on_bmr.pdf).

[13] See https://www.lch.com/membership/ltd-membership/ltd-member-updates/lchs-position-respect-isdas-recommended-benchmark and https://go.cmegroup.com/webmail/502091/246953078/c4c430ec1ffa5d3618b0041ecf552bd457604b162ad217b2498d5f979494f79e.

could be achieved by alignment of how cleared derivatives operate with a pre-cessation trigger for fallbacks in non-cleared contracts if the 2006 ISDA Definitions were to include such a trigger. However, at the same time, CME and LCH have each also communicated to ISDA and regulators that they may elect to consider pre-cessation triggers for fallbacks if LIBOR was found to be non-representative, even if the 2006 ISDA Definitions do not include them.[14]

As explained above, the contemplated Supplement to the 2006 ISDA Definitions amending the IBOR rate options will have the effect of incorporating the new index cessation event trigger and fallbacks in every transaction that incorporates the 2006 ISDA Definitions and has a trade date on or after the date on which the Supplement takes effect. Similarly, adherence to the protocol (or protocols) which ISDA intends to publish will have the effect of amending all legacy derivative contracts between adhering parties that incorporate the 2006 ISDA Definitions (or the 2000 ISDA Definitions) to include the new index cessation event trigger and fallbacks for the relevant IBORs.

As noted above, adherence to a protocol will be strictly voluntary. In the past, adoption of protocols has varied, particularly if law or regulation does not require the amendments made by the protocol. Broad industry support for implementation of the fallback in all legacy derivative contracts is therefore critical for market adoption of the protocol. Concerns regarding the disruption and unpredictable outcomes that could occur under the current fallbacks in the 2006 ISDA Definitions if an IBOR permanently ceases, and the lack of any other alternatives in this scenario (given that nothing will be published to reference for the relevant IBOR), will likely provide incentives for market participants to adhere to the protocol (or otherwise bilaterally amend or close out legacy derivative contracts referencing the IBORs). Again as noted above, market participants and their regulator may view adherence to the protocol, alongside use of the ISDA Benchmarks Supplement, as facilitating or enhancing compliance with regulatory obligations or expectations, such as those under Article 28(2) of the EU Benchmarks Regulation, to produce and maintain robust written plans setting out the actions that they would take in the event that a benchmark materially changes or ceases to be provided and to reflect such plans in the contractual relationship with clients. Adherence may also help regulated firms meet supervisory expectations related to the discontinuation of LIBOR.

[14] The FSB OSSG arranged communication from LCH and CME to ISDA. CME and LCH provided these statements to ISDA for inclusion in this consultation. ISDA has not received communications from any other relevant CCPs. However, before implementing anything in the 2006 ISDA Definitions or otherwise in response to this consultation, ISDA will continue to engage with relevant CCPs to discuss alignment between the cleared and non-cleared derivatives markets.

Focus on transition

In a speech in January 2019, Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA (which supervises the administrator of LIBOR, ICE Benchmark Administration (IBA)), made it clear that "the best and smoothest transition from LIBOR will be one in which contracts that reference LIBOR are replaced or amended before fallback provisions are triggered".[15] Megan Butler, Executive Director of Supervision – Investment, Wholesale and Specialists at the FCA, reiterated this message in her speech in February 2019 where she explained that "the best option is to actively transition to alternative benchmarks".[16] Additionally, in an earlier speech, Andrew Bailey, Chief Executive of the FCA, explained that "fall backs are not designed as, and should not be relied upon, as the primary mechanism for transition […]. That means moving to contracts which do not rely on LIBOR and will not switch reference rates at an unpredictable time".[17]

Derivatives markets are therefore expected to actively transition away from the IBORs by closing out transactions which reference the IBORs, through multilateral compression or by replacing references to the IBORs with references to another rate (such as the relevant RFR, adjusted as appropriate) on a bilateral basis before LIBOR, or another IBOR, is discontinued. This will allow market participants to agree on the precise terms which should apply to the transaction and on the timing of transition.

Work is underway in the public-private sector RFR working groups to consider various potential models or strategies for derivatives market participants to transition away from IBORs on an accelerated basis. These strategies include conversions at both the single trade level and the portfolio level. They also include bilateral conversions as well as multilateral conversions. Some market participants may alternatively choose to close out as much of their exposure to an IBOR as possible to avoid a potential cessation of the rate. It is expected that work on transitioning away from IBORs will pick up in earnest as soon as the volume of new transactions referencing the RFRs increases. While the changes required to transition away from the IBORs will require negotiation, they will allow derivatives market participants to tailor the timing and

[15] Edwin Schooling Latter's speech can be found here: https://www.fca.org.uk/news/speeches/libor-transition-and-contractual-fallbacks.

[16] Megan Butler's speech can be found here: https://www.fca.org.uk/news/speeches/ending-reliance-libor-overview-progress-made-transition-overnight-risk-free-rates-and-what-remains.

[17] Andrew Bailey's speech can be found here: https://www.fca.org.uk/news/speeches/interest-rate-benchmark-reform-transition-world-without-libor.

substance of the changes and the relevant successor rates to specific portfolios, contracts and counterparties. These changes will also allow for precise matching of hedges.

CCPs may deem it appropriate to use an alternative reference rate in cleared contracts, e.g., if the existing rate is no longer sufficiently robust and no longer fit for purpose.[18] CME and LCH have each communicated to ISDA and regulators that pre-cessation events may trigger or prompt them to use their discretion to use an alternative reference rate (if, for example, LIBOR was found to be non-representative), even if the 2006 ISDA Definitions do not include a pre-cessation trigger. CME and LCH have each communicated to ISDA and regulators that public determination by a regulator of a rate's administrator that it is no longer representative would be a directly relevant factor in their assessment of whether the rate continues to be robust or fit for purpose. Further, CME and LCH have each communicated to ISDA that they believe it would be difficult to use an unrepresentative rate as a basis of a market.[19] Adoption of pre-cessation triggers for fallbacks across cleared and non-cleared derivatives would mitigate the risk that hedging relationships across these derivative contracts were broken. Before implementing anything in the 2006 ISDA Definitions or otherwise in response to this consultation, ISDA will continue to engage with relevant CCPs to discuss alignment between the cleared and non-cleared derivatives markets.

Pre-cessation issues

Edwin Schooling Latter's speech and FSB OSSG letter to ISDA

In the speech in which he encouraged market participants to actively transition away from LIBOR, Edwin Schooling Latter also suggested that the "end-game" for LIBOR may include an assessment by the FCA that one or more LIBOR panels have shrunk so significantly that it no

[18] LCH has the right to change the reference rate in a cleared OTC derivative in a number of circumstances, including where it determines in its sole discretion that the existing rate is no longer sufficiently robust or no longer fit for purpose. Per the LCH rulebook, LCH will be able to use an alternative rate to the fallback rate provided by the 2006 ISDA Definitions (or 2000 ISDA Definitions, as applicable) through exercising this discretion. In this scenario, LCH has the sole discretion to determine the replacement reference rate. For more information, see paragraph 1.8.12 of 'LCH Limited Procedures Section 2C SwapClear Clearing Service', available at https://www.lch.com/system/files/media_root/Procedures%202C%20-%2005%20October%202018.pdf.

[19] The FSB OSSG arranged communication from LCH and CME to ISDA. CME and LCH provided these statements to ISDA for inclusion in this consultation. ISDA has not received communications from any other relevant CCPs.

longer considers the relevant rate capable of being representative. Edwin Schooling Latter explained that, were this to happen, the FCA would make a statement that such a benchmark is no longer capable of being representative. In light of this, he suggested that this scenario should be considered when designing fallback triggers and described the advantages of amending or closing out legacy LIBOR contracts upon a statement by the UK FCA that LIBOR is no longer representative. In addition to the inherent advantages of avoiding contractual reliance on LIBOR if it is no longer representative of an underlying market, he cited as other advantages the elimination of exposure to LIBOR in derivatives contracts if the FCA makes the statement because IBA has invoked its reduced submissions policy (which could result in publication of a fixed rate as LIBOR under IBA's current policy) or if market participants are no longer using LIBOR in new contracts as a result of the statement (making it difficult to manage and hedge a portfolio of legacy LIBOR contracts).

In their March 2019 letter to ISDA, the FSB OSSG co-chairs specifically asked that ISDA consult on a potential trigger for fallbacks that would take effect in the event that the FCA found LIBOR to be non-representative and made a statement to that effect, noting that "the EU Benchmarks Regulation envisages some circumstances in which a critical benchmark that does not meet requirements of the Regulation (such as representativeness) continues to be published but EU supervised entities would no longer be able to enter into new derivative or securities transactions referencing LIBOR in such circumstances".[20] Edwin Schooling Latter discussed this possibility in his speech, and indicated that derivative market participants do need to be prepared for a scenario in which LIBOR is found to be non-representative.

[20] http://www.fsb.org/wp-content/uploads/P150319.pdf. As examples of these circumstances, Article 51(4) and Article 35(3) of the EU Benchmarks Regulation both provide that where ceasing or changing a benchmark to fulfil the requirements of the EU Benchmarks Regulation would result in a force majeure event, frustrate or otherwise breach the terms of any financial contract, financial instrument or the rules of any investment fund which references that benchmark, the use of the benchmark may be permitted by the competent authority of the Member State where the index provider is located but only for financial contracts, financial instruments and investment funds that already reference the benchmark. No financial instruments, financial contracts or measurements of the performance of an investment fund shall add a reference to such benchmark (a) in the case of Article 51(4), after the expiry of the transitional provisions and (b) in the case of Article 35(3), during the suspension of authorisation of the administrator. On their face, the transitional provisions under Article 51(4) apply to benchmarks provided by EU administrators that are not authorised under the EU Benchmarks Regulation when the transitional provisions expire. IBA is currently authorised under the EU Benchmarks Regulation. Article 35(3) applies where the administrator's authorisation has been suspended. Pursuant to Article 54 of the EU Benchmarks Regulation, the EU Benchmarks Regulation will be reviewed by 1 January 2020.

In circumstances in which a statement by a relevant regulator that a benchmark is not representative would not, in and of itself, result in a prohibition on the use of the benchmark under the EU Benchmarks Regulation, market participants using that benchmark in derivatives may nevertheless wish to cease using that benchmark following such a statement. Market participants in the jurisdiction of the regulator making the statement may particularly prefer to cease using the benchmark and any market participants that choose to stop using the benchmark in new transactions may also want to amend certain existing transactions that reference the benchmark, as appropriate.

Template fallback wording for inclusion in new cash products

Certain public-private sector RFR working groups, which were initially set up to recommend an alternative RFR for the relevant currency and which are now working on the transition to the RFRs, are considering the publication of template fallback language for inclusion in new cash products. For example, the ARRC consulted on fallback contract language for inclusion in new bilateral business loans, floating rate notes, securitizations and syndicated business loans referencing USD LIBOR and recently published recommended template fallback language for floating rate notes and syndicated business loans.[21]

The triggers in the ARRC's recommended template fallback language include permanent cessation triggers akin to that described above (*i.e.*, an index cessation event). In addition to this, the template fallback language on which the ARRC consulted also included certain "pre-cessation" triggers, for example if there is "a public statement by the regulatory supervisor for the administrator of [the benchmark] announcing that [the benchmark] is no longer representative". Market participants can include the ARRC's template wording in new cash products to the extent that this is agreed upon as part of arm's length contractual negotiations.

Although the ARRC has included a pre-cessation trigger relating to the representativeness of USD LIBOR in its recommended template fallback language for new cash products, not all public-private sector RFR working groups have to date explicitly considered, or taken a view on, fallbacks for cash products or whether a pre-cessation trigger relating to the representativeness of a benchmark should be included in such fallbacks.

[21] The ARRC's recommended fallback language, consultations and responses to the consultations can be found here: https://www.newyorkfed.org/arrc/fallbacks-contract-language. The ARRC is expected to publish recommended fallback language for bilateral business loans and securitizations in the near future.

Existing cash products

Whether or not market participants would also be able to, or intend to, include these triggers and related fallbacks in existing cash products is unclear. Existing cash products cannot be amended by way of a protocol in the same way that derivative contracts can. At the current time, however, it is not clear whether market participants will be able to include the template fallback language recommended by public-private sector RFR working groups, such as the ARRC, in existing cash products. In the case of many legacy bonds, existing fallbacks, if any, would result in the application of the previously published rate if the benchmark were unavailable and, under many legacy loans, cost of funds would apply if the benchmark were unavailable. In many instances, legacy cash market fallback arrangements, if they exist, apply only upon a cessation and do not correspond with the fallback arrangements in the 2006 ISDA Definitions or the new fallbacks described above that ISDA expects to implement.

Implications for hedges

Derivatives are often used to hedge cash products. Market participants may wish to apply the same triggers and fallbacks across cleared and non-cleared derivatives and in the relevant cash product and the related derivative to avoid any mismatch occurring (*e.g.,* where the cash product moves to a new benchmark but the derivative does not or *vice versa*). If new cash products include pre-cessation triggers, market participants may wish to consider including pre-cessation triggers and corresponding fallbacks in new derivatives that hedge those cash products. Similarly, if new or existing cash products do not include pre-cessation triggers and fallbacks, market participants may prefer not to include pre-cessation triggers and fallbacks in derivatives that hedge those cash products. We note that existing cash products may also not contain permanent cessation triggers and fallbacks that correspond with the fallback arrangements in the 2006 ISDA Definitions or the new fallbacks described above that ISDA expects to implement (particularly if the cash products are difficult to amend). Mismatches may occur in a variety of situations in which the relevant triggers and fallbacks may not completely align. However, upon a permanent cessation of the relevant IBOR, the rate referenced in the non-amended cash product would at least change, whereas that would not be the case for the non-amended cash product upon the occurrence of a pre-cessation trigger.

As explained above, an amendment to the 2006 ISDA Definitions by way of a 'Supplement' to include new triggers and fallbacks in the IBOR rate options will apply to all transactions which incorporate the 2006 ISDA Definitions entered into on or after the day on which the Supplement becomes effective. Adherence to the protocol (or protocols) that ISDA intends to publish to incorporate the amended IBOR rate options in legacy transactions will result in the new triggers and fallbacks applying to all legacy transactions that incorporate the 2006 ISDA Definitions (or the 2000 ISDA Definitions) entered into with other adhering parties. Therefore, if ISDA were to include pre-cessation triggers (such as those suggested by the ARRC for new cash products) in the amendments to the 2006 ISDA Definitions and in the protocol (or protocols) that it intends to publish, such pre-cessation triggers and related fallbacks would apply to all new transactions incorporating the 2006 ISDA Definitions and all legacy transactions entered into between adhering parties, regardless of whether those triggers and fallbacks are actually included in relevant cash products. This would avoid mismatches if cash products have equivalent triggers and fallbacks but result in mismatches if they do not. Comparable results could occur if such pre-cessation triggers were not included in amendments to the 2006 ISDA Definitions and the protocol (or protocols) but they were included in related cash products (unless the counterparties separately agree to the triggers and related fallbacks).

As noted in several instances, adherence to the protocol will be strictly voluntary and the amendments made by it are not required by law or regulation (although adherence may help regulated firms meet regulatory obligations or supervisory expectations related to the discontinuation of a Covered IBOR). If pre-cessation triggers and related fallbacks applied in the 2006 ISDA Definitions and therefore in all legacy transactions entered into between adhering parties, then entities that did not agree with such triggers (or did not wish to use such triggers because they would disrupt hedges with cash products that do not include the triggers) may be less likely to adhere to the protocol. This could threaten market wide take up of the protocol. Non-adhering firms and their counterparties would face disruption if an IBOR is permanently discontinued (unless the non-adhering entities amend their derivative contracts bilaterally to include more robust fallbacks). Entities that support pre-cessation triggers (e.g., because they have exposure to cash products with equivalent triggers and fallbacks and/or they want to align with cleared derivatives that may change reference rate if a CCP exercises its discretion described above) may view pre-cessation triggers that would apply to legacy derivative transactions as additional rationale for adhering to the protocol (or protocols).

EU Benchmarks Regulation[22]

Under Article 29(1) of the EU Benchmarks Regulation, EU supervised entities (including certain financial institutions and CCPs) are only permitted to use a benchmark, or a combination of benchmarks, in the EU if the benchmark is either (a) provided by an EU administrator which is included on ESMA's register of administrators or (b) included on ESMA's register of third country benchmarks.[23]

Application of the EU Benchmarks Regulation to LIBOR pre-Brexit

The administrator of LIBOR, IBA, is currently an administrator located in the EU and therefore, in order for LIBOR to be permitted for use under Article 29(1) (after the expiry of the transitional provisions in the EU Benchmarks Regulation[24]), IBA needs to be authorised under Article 34 of the EU Benchmarks Regulation and included in ESMA's register. IBA has completed this process and is currently included on ESMA's register as an authorised administrator.

LIBOR is also a critical benchmark under the EU Benchmarks Regulation. Under Article 23 of the EU Benchmarks Regulation (which applies to critical benchmarks), if a supervised contributor intends to cease contributing to LIBOR, IBA and the UK FCA (as the competent authority responsible for supervising IBA) would be required to assess the implications on the capability of LIBOR to measure the underlying market or economic reality. If the FCA considers that the representativeness of LIBOR is put at risk, the FCA has the power to require supervised entities to contribute input data to IBA for a period of time, determine the form in which (and the time by which) input data is to be contributed and require IBA to change the methodology, its code of conduct for LIBOR contributors or other rules relating to LIBOR.

[22] Note that the discussion herein refers to certain provisions of the EU Benchmarks Regulation. ISDA has not undertaken an exhaustive review of all laws and regulations that may be applicable to an individual market participant. All market participants should seek their own independent legal advice from counsel familiar with their regulatory status and derivatives portfolio. The following terms shall have the meaning given to them in the EU Benchmarks Regulation: "supervised entity", "benchmark", "administrator", "use of a benchmark", "critical benchmark", "contributor", "contribution of input data", "input data", "financial contract", "financial instrument", "investment fund" and "provision of a benchmark".

[23] Article 2 of the EU Benchmarks Regulation sets out a number of entities and benchmarks to which the EU Benchmarks Regulation does not apply.

[24] The transitional period currently expires on 1 January 2020. However, EU regulators have now reached political agreement on extending the transitional provisions under the EU Benchmarks Regulation for critical benchmarks (such as LIBOR and EURIBOR, amongst others) and third country benchmarks from end of 2019 to the end of 2021. http://dsms.consilium.europa.eu/952/Actions/Newsletter.aspx?messageid=29154&customerid=45071&password=enc_6752563661754332656613741_enc and http://europa.eu/rapid/press-release_IP-19-1418_en.htm.

Separately, under Article 11(4), if IBA determines that the input data used to calculate LIBOR does not represent the economic reality that LIBOR is intended to measure, IBA will be obligated, within a reasonable time period, to either (a) change the input data, the contributors or the methodology or (b) cease to provide LIBOR. The length of a "reasonable time period" is not defined in the EU Benchmarks Regulation.

When an administrator no longer meets the conditions under which it was authorised, Article 35 of the EU Benchmarks Regulation empowers the relevant competent authority, such as the FCA, to withdraw or suspend the authorisation of the administrator. In this case, ESMA is required to promptly update its register of administrators and benchmarks and, pursuant to Article 29, EU supervised entities would not be permitted to use in the EU any benchmark (irrespective of currency or tenor) provided by an EU administrator if that administrator is not included in ESMA's register after the expiry of the transitional provisions under the EU Benchmarks Regulation.

In the case where the relevant competent authority decides to suspend the authorisation of the administrator, and where cessation of a benchmark provided by an administrator whose authorisation has been suspended would result in a force majeure event or frustrate or otherwise breach the terms of a financial contract, financial instrument or investment fund which references the benchmark, the competent authority for the administrator may permit continued provision of the benchmark until the suspension is withdrawn and, during that time, EU supervised entities will be permitted to use the benchmark only in financial contracts, financial instruments and investment funds which already reference such benchmark. The use of the benchmark by EU supervised entities in new financial contracts, financial instruments and investment funds would not be permitted.

Pursuant to Article 54 of the EU Benchmarks Regulation, the EU Benchmarks Regulation will be reviewed by 1 January 2020.[25]

Application of the EU Benchmarks Regulation and the UK onshored version of the Benchmarks Regulation to LIBOR post-Brexit

Post-Brexit, the FCA's register of administrators and benchmarks would need to include IBA in order to permit use of LIBOR in the UK by UK supervised entities.

Post-Brexit, IBA would also need to qualify its benchmarks for use in the EU prior to expiry of the transitional period under the EU Benchmarks Regulation by means of equivalence, endorsement or recognition. If this occurred, then it would result in LIBOR appearing on

[25] See also Edwin Schooling Latter's speech which acknowledged this review: https://www.fca.org.uk/news/speeches/libor-transition-and-contractual-fallbacks.

ESMA's register of third country benchmarks (which lists all benchmarks provided by non-EU administrators that comply with the equivalence, recognition or endorsement requirements under Article 30, 32 or 33, respectively, of the EU Benchmarks Regulation). Under the EU Benchmarks Regulation, such approval can be suspended or withdrawn in certain circumstances (see Articles 31, 32(8) and 33(6)[26]).

If IBA did not obtain equivalence, endorsement or recognition, Article 51(5) would permit the use of LIBOR in financial contracts, financial instruments and investment funds that already reference LIBOR in the EU on, or which add a reference to LIBOR prior to, the expiry of the transitional provisions. In these circumstances, after the expiry of the transitional provisions, EU supervised entities would not be permitted to use LIBOR in new financial contracts, financial instruments and investment funds.

ISDA has not undertaken an exhaustive review of all laws and regulations that may be applicable to an individual market participant. All market participants should seek their own independent legal advice from counsel familiar with their regulatory status and derivatives portfolio.

[26] Article 31 of the EU Benchmarks Regulation provides that ESMA shall, after following certain processes to liaise with the competent authority of the relevant third country, withdraw the registration of an administrator located in a third country by removing that administrator from the register where it has well-founded reasons, based on documented evidence, that the administrator (a) is acting in a manner which is clearly prejudicial to the interests of the users of its benchmarks or the orderly functioning of markets or (b) has seriously infringed the national legislation in the third country or other provisions applicable to it in the third country and on the basis of which the Commission has taken an implementing decision relating to equivalence. Article 32(8) similarly provides that the competent authority of the EU member state of reference (which is determined under Article 32(4)) shall suspend or, where appropriate, withdraw recognition in similar circumstances (e.g. if the administrator is acting in a manner which is clearly prejudicial to the interests of the users of its benchmarks or the orderly functioning of markets or has seriously infringed the relevant requirements set out in the EU Benchmarks Regulation). Article 33(6) provides that the competent authority of an endorsing administrator or other supervised entity shall have the power to require the endorsing administrator or other supervised entity to cease the endorsement if it has well-founded reasons to consider that the conditions on which endorsement was granted are no longer fulfilled.

Questions

The deadline for responses is July 12, 2019. This deadline will not be extended. Please email your response to FallbackConsult@isda.org and clearly indicate that you are submitting a response in the subject line of your email. For your convenience, you can use this form for your responses (but you are not required to do so).

During the consultation period, ISDA will publish a webinar to introduce the consultation. This will be during the week of May 20, 2019. You can also submit questions to fallbackconsult@isda.org at any time during the consultation period.

Note to Recipients: By participating in this consultation, you agree not to use this process for any anticompetitive purpose, and further agree and warrant that you will not engage in any conduct that would cause any other party participating in this consultation to be in violation of any competition or antitrust law or regulation. ISDA has taken and will continue to take safeguards and protections to ensure that the use of the results of this consultation comply with applicable laws and regulations.

In addition to the questions below, please feel free to comment on all aspects of the topics discussed above. Please also comment on whether additional information would be helpful to understand and analyze the topics discussed above.

As described above, the UK FCA has suggested that the "end-game" for LIBOR may include an assessment by the FCA that one or more LIBOR panels have shrunk so significantly that it no longer considers the relevant rate capable of being representative.

1. Would you be content to have any contracts that continue to reference the Covered IBOR after the supervisor of the Covered IBOR's administrator makes a statement that the Covered IBOR is no longer representative? If so, why and under what circumstances?

2. What actions would you take if the supervisor of a Covered IBOR administrator makes a statement that a Covered IBOR is no longer representative but the Covered IBOR continues to be published? Please differentiate between ceasing use of that Covered IBOR in *new* derivative contracts and negotiating amendments to *existing* derivative contracts. Please comment on LIBOR in particular and explain whether your answers differ across Covered IBORs. Would the facts and circumstances surrounding the supervisor's assessment and statement affect your actions? If so, how?

3. Do you expect to amend or close out your derivative contracts referencing Covered IBORs prior to the possibility of a statement that a Covered IBOR is no longer representative? Please specifically comment on whether you expect to have exposure to LIBOR post-2021.

4. Do you expect any impediments to taking the steps you would want to take? How could ISDA mitigate these impediments? What other entities could mitigate these impediments and how could they do so?

ISDA IBOR Fallbacks

5. Would it be appropriate to include a pre-cessation trigger regarding 'representativeness' with the triggers for permanent cessation in the amendments to the 2006 ISDA Definitions and in the protocol that ISDA intends to publish to introduce the IBOR fallbacks? Please explain your answer.

6. Is inclusion of the trigger necessary to enhance existing controls and mechanisms already in place contractually and/or under existing law or are these controls and mechanisms sufficient?

7. What problems could arise if such a trigger were not included in amendments to the 2006 ISDA Definitions and in the protocol that ISDA intends to publish to introduce the IBOR Fallbacks? Please specifically consider and comment on (a) the potential for a CCP to exercise its discretion to change a reference rate if it determines that a Covered IBOR is no longer sufficiently robust or no longer fit for purpose; (b) management of a legacy portfolio of derivatives referencing an IBOR if use in new contracts is also prohibited by regulation (at least for entities in certain jurisdictions); and (c) derivatives that hedge cash instruments that may have pre-cessation triggers and fallbacks.

8. What problems could arise if such a trigger were included? Please also consider derivatives that hedge cash instruments that do not have pre-cessation triggers and fallbacks. Please consider the implications of linking the fallbacks for the permanent cessation of a Covered IBOR with the agreement to convert the Covered IBOR to the corresponding adjusted RFR plus a spread upon a pre-cessation trigger.

9. Do you think inclusion of a pre-cessation trigger would positively or negatively affect industry take up of the permanent cessation fallbacks? Please specifically comment on adherence to the protocol to amend legacy derivative contracts.

10. What problems could arise if such a trigger were not included in amendments to the 2006 ISDA Definitions and in the protocol that ISDA intends to publish to implement the IBOR Fallbacks?

As an alternative, ISDA could potentially publish a protocol including pre-cessation triggers and related fallbacks that allows adherents to (a) exclude certain transactions, (b) only include certain transactions, (c) require both counterparties to agree to include the pre-cessation trigger and related fallback through a "matching" function and/or (d) allow both counterparties to agree to exclude the pre-cessation trigger and related fallback through a "matching" function. Additional variations of the foregoing may also be possible. Any amendments made pursuant to such a protocol would apply in addition to the permanent cessation triggers and ISDA IBOR fallbacks and would be implemented in a way that does not add optionality to inclusion of those fallbacks upon the occurrence of a permanent cessation of a Covered IBOR in existing transactions between adhering parties.

11. Would such a protocol be helpful to address concerns regarding 'non-representative' benchmarks? If so, which of the approaches listed above (and/or variations of these approaches) do you prefer?

12. Please comment on the relative disadvantages and advantages of such a protocol as compared to inclusion of a pre-cessation trigger in the 2006 ISDA Definitions and the protocol that ISDA intends to publish to implement the IBOR Fallbacks without any ability to elect for or against inclusion of such a pre-cessation trigger.

13. Would you prefer using such a protocol as opposed to template language for bilateral incorporation in derivative contracts to address concerns regarding 'non-representative' benchmarks, and other pre-cessation concerns you may have?

14. Do you have any other suggestions for flexible solutions to include pre-cessation triggers and corresponding fallbacks in derivative contracts on a *voluntary* basis that are less burdensome than template language for bilateral incorporation?

If the Covered IBOR continues after counterparties convert to the adjusted RFR plus a spread, the counterparties would be able to determine whether they are receiving/paying more or less on the basis of the adjusted RFR plus the spread by comparison with the unrepresentative Covered IBOR that continues to be published.

15. Would it be appropriate to use the adjusted RFR plus a spread under these circumstances or could it be problematic? Please explain.

16. Is there a way to mitigate against any concerns regarding the fact that counterparties could determine this?

17. If you would not want to replace references to the Covered IBOR with references to the adjusted RFR plus a spread under these circumstances, what other amendments to existing derivative contracts would you want to make following such a statement?

If the supervisor of the administrator made a statement that a Covered IBOR is no longer representative and, as a result, derivative contracts are amended to reference the adjusted RFR plus a spread calculated by reference to historical data at the time the relevant regulator makes such a statement, and the Covered IBOR is subsequently permanently discontinued following an 'index cessation event' (as set out on pages 2 to 3 above), the spread that would apply for the permanent cessation fallbacks would differ from the spread that applied for the pre-cessation fallbacks (i.e. because the spread would be fixed at different times by reference to historical data available, in the case of the pre-cessation trigger, when the non-representativeness statement is made and, in the case of the permanent cessation trigger, when the statement regarding permanent cessation is made).

18. In this scenario, should the spread adjustment following permanent discontinuation of the Covered IBOR automatically change to the 'permanent cessation' spread (*i.e.,* a spread calculated by reference to historical data at the time the announcement is made in respect of permanent cessation)? Alternatively, should it remain at the spread adjustment for the 'pre-cessation' event?[27]

19. Would it be problematic to have multiple spread adjustments apply based on when the fallbacks took effect (*i.e.,* prior to cessation or upon cessation)?

20. If adherents to a protocol of the type described in questions 11-14 above exclude a pre-cessation trigger for fallbacks in certain contracts and/or with certain counterparties, should they agree that the spread adjustment related to the pre-cessation trigger would nevertheless apply if a permanent cessation occurs?

[27] This is the approach in the ARRC's template fallback language for cash products.

Glossary

2006 ISDA Definitions: 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 effective.

Alternative Reference Rates Committee (ARRC): The public-private sector working group in the United States which is responsible for choosing SOFR as the preferred RFR for the US dollar and which is now planning the transition from USD LIBOR to SOFR.

Bank Bill Swap Rate (BBSW): The Bank Bill Swap Rate administered by the Australian Securities Exchange.

CDOR: The Canadian Dollar Offered Rate administered by Refinitiv Benchmark Services (UK) Limited.

Central Counterparty (CCP): A financial entity that stands between counterparties of a trade in order to mitigate counterparty credit risk, acting as the buyer to every seller and the seller to every buyer. A CCP nets transactions between counterparties on a multilateral basis, resulting in lower gross exposures. Counterparties are required to contribute margin and other resources on a regular basis to cover losses. Once the resources contributed by a defaulting entity are depleted, any further losses are mutualized.

CORRA: The Canadian Overnight Repo Rate Average administered by Refinitiv Benchmark Services (UK) Limited.

EU Benchmarks Regulation: Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

Euro Interbank Offered Rate (EURIBOR): The Euro Interbank Offered Rate administered by the European Money Markets Institute.

Euro Short Term Rate (€STR): The Euro Short Term Rate to be administered by the European Central Bank.

European Securities and Markets Authority (ESMA): An independent EU Authority that contributes to safeguarding the stability of the EU's financial system by enhancing the protection of investors and promoting stable and orderly financial markets.

Financial Conduct Authority (FCA): The United Kingdom Financial Conduct Authority, which is responsible for supervising UK benchmark administrators such as IBA, amongst other entities.

Financial Services and Markets Authority (FSMA): The Belgian Financial Services and Markets Authority, which is responsible for supervising benchmark administrators such as the European Money Markets Institute, which is the administrator for EURIBOR, amongst other benchmarks.

Financial Stability Board (FSB): An international body that monitors and makes recommendations about the global financial system. The FSB was established in April 2009, as the successor to the Financial Stability Forum, with a broadened mandate to promote financial stability.

HKD Overnight Index Average (HONIA): The Hong Kong Dollar Overnight Index Average administered by the Treasury Markets Association.

Hong Kong Interbank Offered Rate (HIBOR): The Hong Kong Interbank Offered Rate administered by the Treasury Markets Association.

ICE Benchmark Administration (IBA): The administrator for LIBOR, amongst other benchmarks.

Interbank Offered Rates (IBORs): Average rates at which certain banks could borrow in the interbank market, which range in tenors from overnight to 12 months. The rates include a spread reflecting the credit risk involved in lending money to banks. In this document, LIBOR, EURIBOR, TIBOR, BBSW, CDOR and HIBOR are collectively known as the 'IBORs'.

ISDA Master Agreement: A standard form master agreement published by ISDA such as an ISDA 2002 Master Agreement, an ISDA 2002 Master Agreement (French law), an ISDA 2002 Master Agreement (Irish law), a 1992 ISDA Master Agreement (Multicurrency – Cross Border), a 1992 ISDA Master Agreement (Local Currency – Single Jurisdiction) or a 1987 ISDA Interest Rate and Currency Exchange Agreement.

London Interbank Offered Rate (LIBOR): The London Interbank Offered Rate administered by IBA.

Official Sector Steering Group (OSSG): In February 2013, the G-20 nations commissioned the FSB to review and reform major interest rate benchmarks. In June 2013, the Financial Stability Board established the OSSG comprised of senior officials from central banks and regulatory agencies to focus on interest rate benchmarks. The OSSG recommended enhancing LIBOR and other IBOR benchmarks, selecting alternative risk-free benchmarks and developing plans to transition to them, and implementing contractual fallbacks that would apply in the event of permanent discontinuation of an IBOR. The OSSG published its Reforming Major Interest Rate Benchmarks report in July 2014 and has since published updates in 2015, 2016, 2017 and 2018.

Protocol: A multilateral contractual amendment mechanism that has been used to effectuate standard amendments to ISDA documentation among adhering counterparties. The first protocol that ISDA launched was the ISDA EMU Protocol in 1998, which addressed contractual and legal certainty issues arising from the implementation of the European Monetary Union. This protocol and many others since 1998 have provided an efficient way of implementing industry standard contractual changes over a broad number of counterparties. Legally, the effect of protocols is the same as bilateral amendments among adhering parties but protocols have the benefit of eliminating the need for costly and time-consuming bilateral negotiations.

Rate Option: The price source or 'interest rate benchmark' for the floating rate leg of a swap transaction. The rate options are set forth in Section 7.1 of the 2006 ISDA Definitions. Counterparties to swap transactions that reference the 2006 ISDA Definitions may specify one of the rate options in their confirmations. By doing so, the counterparties agree that the terms of that rate option will govern the amount that is payable by the floating rate payer on the applicable payment date. The fallbacks that ISDA is implementing for certain IBORs will be amendments to the rate options for the relevant IBORs.

Reserve Bank of Australia (RBA) Cash Rate: The interbank overnight cash rate administered by the Reserve Bank of Australia. The 2006 ISDA Definitions refer to this rate as the AUD Overnight Index Average (AONIA).

Risk-free Rates (RFRs): Average rates of investments that are risk free or nearly risk free. Unlike the IBORs, RFRs do not account for credit risk involved in lending money to banks. In this document, SONIA, TONA, SARON, SOFR, the RBA cash rate, ESTER, CORRA and HONIA are collectively known as the 'RFRs'.

Secured Overnight Financing Rate (SOFR): The secured overnight financing rate administered by the Federal Reserve Bank of New York.

Sterling Overnight Index Average (SONIA): The Sterling Overnight Index Average administered by the Bank of England.

Swiss Average Rate Overnight (SARON): The Swiss Average Rate Overnight administered by SIX Swiss Exchange.

Tokyo Interbank Offered Rate (TIBOR): The Tokyo Interbank Offered Rate administered by the JBA TIBOR Administration (JBATA).

Tokyo Overnight Average Rate (TONA): The Tokyo Overnight Average Rate administered by the Bank of Japan.