

# Development of Fallbacks for LIBOR and other Key IBORs



Work of the FSB OSSG and ISDA

# Development of Fallbacks for IBORs

## Background

- FSB Official Sector Steering Group (OSSG) Market Participants Group Final Report (July 2014)
  - In most cases, fallback provisions are not sufficiently robust for a permanent discontinuation of a key IBOR
- IOSCO *Principles for Financial Benchmarks* Principle 13
  - Users should be encouraged to have robust fallback provisions in contracts or financial instruments that reference a benchmark in the event of cessation of the referenced benchmark
- FSB OSSG Letter to ISDA (July 2016)
- ISDA Response to FSB OSSG (September 2016)

## Recent

- *The Future of LIBOR* July 2017 speech by the UK FCA's Andrew Bailey (<https://www.fca.org.uk/news/speeches/the-future-of-libor>)
  - UK FCA will not use its influence or legal powers to persuade or compel panel banks to make LIBOR submissions after the end of 2021

## ISDA Working Groups

- Currencies covered:
  - USD
  - GBP/EUR/CHF
  - JPY
  - AUD/SGD/HKD
- Expected to address the following:
  - Suggestion of a fallback rate, or if determined necessary, fallback rates and/or other fallback mechanisms, that would apply in the event that the applicable IBOR is permanently discontinued
  - Amendments to the ISDA 2006 Definitions to add selected fallbacks that would apply upon any such permanent discontinuation
  - Development of a proposed plan to amend legacy contracts referencing the applicable IBORs to include the amended definitions, including potential development of a protocol mechanism to facilitate multilateral amendments

## Related Work on Transitions to Risk-free Rates

- FSB *Reforming Major Interest Rate Benchmarks* (July 2014)
- FSB OSSG recommendations
  - Certain financial transactions, including many derivatives transactions, are better suited to reference rates that are closer to risk-free
- Major currency groups and rates selected:

United States	Alternative Reference Rates Committee (ARRC)	Broad Treasuries Repo Financing Rate
United Kingdom	Working Group on Sterling Risk-Free Reference Rates	Reformed SONIA
Japan	Study Group on Risk-Free Reference Rates	TONA

- Current focus is on developing plans for transitions from IBORs to identified rates

# ISDA Work

## Preliminary conclusions

- Triggers (in each case, the fallback would apply as of the first date that the relevant IBOR is not published after it is permanently discontinued (not as of the date of any prior announcement))
  - The insolvency of the relevant IBOR administrator (and there is no successor administrator)
  - A public statement by the relevant IBOR administrator that it will cease publishing the relevant IBOR permanently or indefinitely (and there is no successor administrator that will continue publication of the relevant IBOR)
  - A public statement by the supervisor for the relevant IBOR administrator that the relevant IBOR has been permanently or indefinitely discontinued
  - A statement by the supervisor for the relevant IBOR administrator that the relevant IBOR may no longer be used
- Alternative risk-free rates as fallbacks
  - GBP: SONIA
  - JPY: TONA
  - USD: Broad Treasuries Repo Financing Rate

## ISDA Work (continued)

### Issues to be addressed assuming fallback is to identified risk-free rate:

- Need spreads to apply to risk-free rate if fallback is triggered (to account for bank credit risk captured by IBORs but not RFRs)
  - Methodology for calculating the spreads - Key considerations:
    - Eliminate or minimize value transfer at the time the fallback is applied
    - Eliminate or minimize any potential for manipulation
    - Avoid distortion due to market stress at time the fallback is applied
  - Sources of inputs for calculation of spreads
  - Entity to calculate spreads
  - Entity to publish spreads
- Need to capture forward term structure
  - 1/3/6/12 month OIS for risk-free rate
  - Alternative ways to calculate

### Other issues:

- Alternative risk-free rates that do not yet exist
- Basis risk if entire market does not move to new fallbacks
- Suitability for end users

## ISDA Work (continued)

### Expected next steps:

- End-user outreach
- Spread methodology, calculation and publication
  - Vendor outreach
- Outreach to other trade associations, etc.
- Draft amendments to ISDA 2006 Definitions
- Determine appropriate implementation timing
- Potential development of protocol to amend legacy contracts