

ISDA IBOR Fallback Update



October 2019

ISDA IBOR Fallbacks: Implementation in ISDA Documentation

- Amendments to relevant floating rate options in Section 7.1 of the **2006 ISDA Definitions**
 - Amended and restated floating rate options will generally include:
 - The existing price source information;
 - A statement identifying the objective triggers for a ‘permanent cessation’ that would activate the selected fallbacks; and
 - A description of the fallback that would apply upon the occurrence of that trigger, which will be the adjusted RFR plus the spread adjustment
- Floating rate options in the 2006 ISDA Definitions are generally incorporated by reference into confirmations for uncleared interest rate derivatives and the rulebooks of CCPs that clear interest rate derivatives
- Amendments will be implemented via a ‘Supplement’ to the 2006 ISDA Definitions (currently almost 60 supplements)
- Upon publication of the Supplement amending the relevant floating rate option, all *new* derivative transactions that incorporate the 2006 ISDA Definitions will include the fallbacks (counterparties will *not* have to take any additional steps)

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- ISDA will also publish a **Protocol** to facilitate inclusion of the amended definitions (i.e. the definitions with fallbacks) into *existing* derivative transactions that were entered into prior to publication of the relevant Supplement
 - Will apply to existing derivatives transactions that incorporate either the 2006 ISDA Definitions or the 2000 ISDA Definitions
- Adherents to the Protocol will agree that derivatives transactions that they have entered into *with other adherents* prior to publication of the relevant Supplement will be based on the relevant amended floating rate options in the 2006 ISDA Definitions, notwithstanding of the dates of the transactions
- Existing derivatives transactions entered into prior to the date of the relevant Supplement amending the 2006 ISDA Definitions between counterparties that do not *both* adhere to the protocol, or otherwise (e.g. bilaterally) agree to include the amended definitions in their transactions, will not include the fallbacks

ISDA May 2019 Fallback Consultations Results – Supplemental Consultation

2019 Supplemental Consultations on spread and term adjustments for fallbacks in derivatives referencing USD LIBOR, CDOR, and HIBOR (and certain aspects of fallbacks for SOR):

- Consultation ran May 16-July 12, 2019
- This supplemental consultation built on the 2018 consultation regarding spread and term adjustments for fallbacks in derivatives referencing GBP LIBOR, CHF LIBOR, JPY LIBOR, TIBOR, Euroyen TIBOR, and BBSW.
- ISDA received feedback from 85 entities in a variety of jurisdictions, including banks, asset managers, pension funds, insurance companies, central counterparties (CCPs) and government entities. Consistent with the 2018 Consultation, the overwhelming majority of respondents preferred the “compounded setting in arrears rate” for the adjusted risk-free rate (RFR) and the “historical mean/median approach” for the spread adjustment.
- Respondents cited both support for the substance of these approaches and a strong desire to use the same adjusted RFR and spread adjustment across all benchmarks covered by the supplemental consultation and last year’s consultation (as well as potentially other benchmarks such as EUR LIBOR and EURIBOR, for which ISDA expects to launch a supplemental consultation at EoY 2019 or Q1 2020).
- Based on the foregoing and subject to the ongoing work and ultimate decision of the ISDA Board Benchmark Committee, ISDA expects to 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 USD LIBOR, CDOR and HIBOR.

Term and Spread Adjustments

- The **Compounded Setting in Arrears Rate** is the relevant RFR observed over the relevant IBOR tenor and compounded daily during that period
 - Need to calculate and publish for each relevant IBOR tenor
 - Need to analyze and address technical adjustments necessary to fallback from a forward-looking term rate that is available at the beginning of the period to a compounded rate that is not available until the end of the period (including, e.g., adjustments to payment dates, lock-out periods)
- The **Historical Mean/Median Approach** to the spread adjustment is based on the mean or median spot spread between the IBOR and the adjusted RFR calculated over a significant, static lookback period prior to the relevant announcement or publication triggering the fallback provisions
 - Need to calculate and publish for each relevant IBOR tenor based on historical differences between the IBOR for that tenor and the relevant RFR compounded over the relevant tenor (so, the spread will differ across different tenors for the same IBOR)
 - Need to determine final parameters, including whether to use the mean or the median, the length of the relevant lookback period, whether to use a transitional period (as described in the recent consultation) and whether to apply any other variations (some of which are described in the summary of consultation results)

ISDA September 2019 Consultation – Final Parameters

ISDA September 2019 Consultation on Final Parameters

- Seeks input on the final parameters related for the (1) compounded setting in arrears rate and (2) historical mean/median approach to the spread adjustment
- *Compounded setting in arrears rate*
 - Is it necessary to apply a backward-shift, lockout or similar adjustment to avoid making payments on the same date as the date on which the fallback rate is known?
 - If so, what adjustment should apply?
 - Related technical questions
- *Historical mean/median approach to the spread adjustment*
 - Two primary options based on responses to 2018 consultation and 2019 supplemental consultation:
 - Median with five-year lookback period from announcement regarding cessation
 - Trimmed with ten-year lookback period from announcement regarding cessation
 - Related technical questions
- **Open through October 23, 2019 – Feedback on open issues is critical**

ISDA May 2019 Fallback Consultations Results – Pre-Cessation Issues

2019 Pre-cessation Consultation for LIBOR and Certain Other Interbank Offered Rates:

- Consultation ran May 16-July 12, 2019
- ISDA received responses from 89 entities in a variety of jurisdictions, including a variety of market participants including banks and broker-dealers, insurance companies, asset managers, government/federal entities and CCPs.
- Respondents expressed a wide variety of views regarding whether and how to implement a precessation trigger related to “non-representativeness” for derivatives.
- In general, the respondents fell into three categories, without a clear majority in any one category:
 - Those who supported adding a pre-cessation trigger to the permanent cessation triggers in the “hard wired” amendment to the 2006 ISDA Definitions and related protocol.
 - Those who supported use of the pre-cessation trigger provided that it was implemented with optionality and flexibility (or indicated that their support for the trigger depended on a number of factors).
 - Those who opposed the pre-cessation trigger.
- Respondents also expressed a number of issues for consideration related to the potential precessation trigger itself and how to implement such a trigger.

IBOR Fallbacks: ISDA's 2019 Work Plan

- Supplemental consultation on the term and spread adjustments for USD LIBOR, CDOR and HIBOR – *Completed July 2019 and final results published September 2019*
- Consultation seeking further input on the preferred approach for addressing pre-cessation issues in derivatives that reference LIBOR and potentially other IBORs, including in the context of a regulator's statement that the relevant IBOR is no longer representative – *Completed July 2019 and preliminary results published August 2019*
- Selection of vendor to publish term and spread adjustments – *Completed July 2019 (Bloomberg was selected in a competitive RFP)*
- Consultation on open issues associated with the final parameters for the term and spread adjustments. This consultation will cover all previous consulted IBORs – *Outstanding and comments are due **October 23, 2019***
- Publication of anonymized summary of responses to consultation on pre-cessation issues – *To be published in October 2019*
- Publication of amended definitions and protocol for all covered IBORs except EUR LIBOR and EURIBOR – *Q4 2019 (with effective date in H1 2020)*
- Supplemental consultation on the term and spread adjustments for EUR LIBOR and EURIBOR – *TBD (likely Q4 2019 or Q1 2020)*