ISDA IBOR Fallbacks

ISDA Safe, Efficient Markets

July 2018

IBOR Fallbacks: Background

- Per the request of the FSB OSSG in 2016, ISDA will amend the **2006 ISDA Definitions** to implement **fallbacks for: LIBOR in USD, GBP, JPY, CHF and EUR; EURIBOR, JPY TIBOR, Euroyen TIBOR, BBSW and HIBOR** (the 'IBORs').
- The fallbacks will apply upon the ***permanent discontinuation*** of the relevant IBOR (based on pre-determined, objective triggers) and will be to the relevant alternative risk-free rate ('RFR'), subject to term and spread adjustments.

IBOR	Fallback Rate
USD LIBOR	SOFR
GBP LIBOR	SONIA
JPY LIBOR JPY TIBOR EUROYEN TIBOR	TONA
CHF LIBOR	SARON
EURO LIBOR EURIBOR	TBD
BBSW	Cash rate published by the RBA
Others (SGD, HKD)	TBD

- ISDA will also publish a protocol to facilitate inclusion of the amended definitions (*i.e.,* the definitions with fallbacks) into existing derivatives contracts (as amendments to the 2006 ISDA Definitions apply to transactions entered into on or after the date of such amendments only).

IBOR Fallbacks: Background

Triggers. The fallbacks in the 2006 ISDA Definitions will be triggered upon:

- a public statement or publication of information by or on behalf of the administrator of [the relevant IBOR][8] announcing that it has ceased or will cease to provide [the relevant IBOR] permanently or indefinitely, provided that, at that time, there is no successor administrator that will continue to provide [the relevant IBOR]; or
- 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 that time, 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).

ISDA continues to work with its members and relevant regulators to determine what additional documentation solutions may be helpful with respect to adoption of, and transition to, alternative rates prior to the permanent discontinuation of an IBOR.

IBOR Fallbacks: Market Consultation on Approaches to Term and Spread Adjustments

- Last week ISDA launched a **market consultation (of ISDA members and non-members)** to inform final decisions regarding the approaches to **term and spread adjustments** for derivatives fallbacks. It is necessary to address these issues because the fallback RFRs are overnight and risk-free (or nearly risk-free) whereas the relevant IBORs have term structures and incorporate a bank credit risk premium and a variety of other factors (*e.g.,* liquidity, fluctuations in supply and demand).
  - The consultation is available at https://www.isda.org/2018/07/12/interbank-offered-rate-ibor-fallbacks-for-2006-isda-definitions.
  - The consultation will remain open until October 12th, 2018.
  - ISDA will analyze the responses to this consultation and determine the approach for calculating the term and spread adjustments (or determine appropriate next steps).
  - ISDA will publish a full explanation of how it made the determination based on the responses received.

- Incorporation of the new fallbacks is ultimately voluntary. It is therefore critical that market participants provide their comments to ensure widespread adoption of the fallbacks ISDA plans to implement.

- While the consultation is outstanding, ISDA will begin outreach to vendors who are interested in administering and publishing the spread adjustments.

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IBOR Fallbacks: Market Consultation on Approaches to Term and Spread Adjustments

The consultation requests feed back on **three possible approaches to spread adjustments** and **four possible approaches to term adjustments**:

Spread Methodologies

- **Forward Approach** – calculated based on observed market prices for the forward spread between the relevant IBOR and RFR in the relevant tenor at the time of trigger

- **Historical Mean/ Median Approach** – based on the mean or median spot spread between the relevant IBOR and RFR calculated over a significant, static lookback period (*e.g.,* 5 or 10 years)

- **Spot-Spread Approach** – based on the spot spread between the relevant IBOR and RFR on the day preceding the relevant announcement or publication of the event triggering the fallback

Approaches to Term Adjustments

- **Spot Overnight Rate** – the RFR that sets on the date that is one or two business days prior to the beginning of the relevant IBOR tenor

- **Convexity-adjusted Overnight Rate** – similar to the spot overnight rate, but attempts to account for the difference between flat overnight interest at the spot overnight rate versus the realized rate of interest that would be delivered by daily compounding of the RFR over the relevant IBOR tenor

- **Compounding Setting in Arrears Rate** – the RFR observed over the relevant IBOR tenor and compounded daily during that period

- **Compounded Setting in Advance Rate** – similar to compounded in arrears rate but with an observation period ending prior to the start of the relevant IBOR tenor

IBOR Fallbacks: Looking Forward

- **Later 2018-2019:** Supplemental consultations on the term and spread adjustments for USD LIBOR, EUR LIBOR, EURIBOR and HIBOR. Exact timing is uncertain and contingent on sufficient trading developing in the fallback rates (*i.e.,* SOFR for USD LIBOR, HONIA for HIBOR and the rate ultimately selected by the EUR RFR Working Group for EUR LIBOR and EURIBOR).

- **2019:** Fallbacks for GBP LIBOR, JPY LIBOR, JPY TIBOR, Euroyen TIBOR, CHF LIBOR and BBSW expected to be implemented in 2006 ISDA Definitions and expected launch of protocol to include the amended definitions in existing derivatives contracts (exact timing contingent on time required for a vendor build and for legal and regulatory approvals).

- **2019-Onward:** Fallbacks for USD LIBOR, EUR LIBOR, EURIBOR and HIBOR expected to be implemented in 2006 ISDA Definitions and expected launch of protocol to include the amended definitions into existing derivatives contracts.