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Fallback benchmarks for main IBORs: consultation published by ISDA

ISDA, the International Swaps and Derivatives Association, is planning to amend certain “floating rate options” in the 2006 ISDA Definitions in order to include fallback benchmarks that would apply upon the permanent discontinuation (based on defined triggers) of certain key interbank offered rates (“IBORs”). In this perspective, ISDA has published a consultation which seeks for market participants’ input on the technical issues encountered when determining such fallback benchmarks (the “Consultation”).

The Consultation is published in the context of the work initiated in July 2016 by the Financial Stability Board in order 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, the selection and contractual implementation of fallback benchmarks for key IBORs.

Not all the key IBORs are addressed in the Consultation, which first focused on LIBORs (GBP, CHF JPY), TIBOR, Euroyen TIBOR and BBSW. Supplemental consultations covering other key IBORs will be launched at a later stage.

Similarly to the approach adopted in Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, the implementation of fallback benchmarks in the ISDA 2006 Definitions should prevent a potential serious market disruption which could occur in case where key benchmarks would be permanently discontinued.

The Consultation is outlining the following key aspects related to its choice of fallback benchmarks:

– **Definition of permanent discontinuation of an IBOR.** In the Consultation, ISDA defines the triggers which would lead to an index being deemed as "permanently discontinued". The definition proposed by ISDA may be relevant for any market player having to determine when an index is permanently discontinued for the purpose of its own contingency plan with respect to the use it makes of an index.

– **Choice of fallback benchmarks.** For each key IBOR in scope of its analysis, ISDA proposed an alternative risk free rate (“RFR”) in the relevant currency as the corresponding fallback benchmark.

– **Adjustments to be made to the RFRs as fallback benchmarks.** While IBORs are published for various tenors, RFRs are all overnight rates. In addition, IBORs include a risk component (*e.g.* market risk, regulatory risk, solvency risk, etc.) whereas RFRs are representing the risk free or near risk free rate applying in the market. As a result, ISDA has determined that when used as fallback benchmarks for IBORs, RFRs should be subject to two levels of adjustments, one which will aim at reflecting the duration characteristics and the other which will aim at reflecting the risk characteristics of the relevant IBOR. The foreseen methods for implementing such adjustments are at the core of the Consultation. Once the Consultation has been finalised, its results may also prove useful for users of IBORs outside of the derivatives' contracts as a market standard for replacement benchmarks.

Market Participants had until 12 October 2018 to provide ISDA with their feedback on the Consultation.

To see the ISDA Consultation on Certain Aspects of Fallbacks for Derivatives Referencing GBP LIBOR, CHF LIBOR, JPY LIBOR, TIBOR, Euroyen TIBOR and BBSW, please click here.

To see the document issued by Bloomberg in order to illustrate certain of the options for adjustments under consideration in the Consultation, please click here.

We remain at your disposal for any further questions.

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