

# Update on ISDA's Benchmarks Initiatives



**July 2018**

# The IBOR Roadmap, Survey and Report

- ISDA, AFME, ICMA, SIFMA and SIFMA AMG:
  - IBOR Global Transition Roadmap – February 2018.
  - IBOR Global Transition Survey – April 2018
  - IBOR Global Transition Report – May 2018

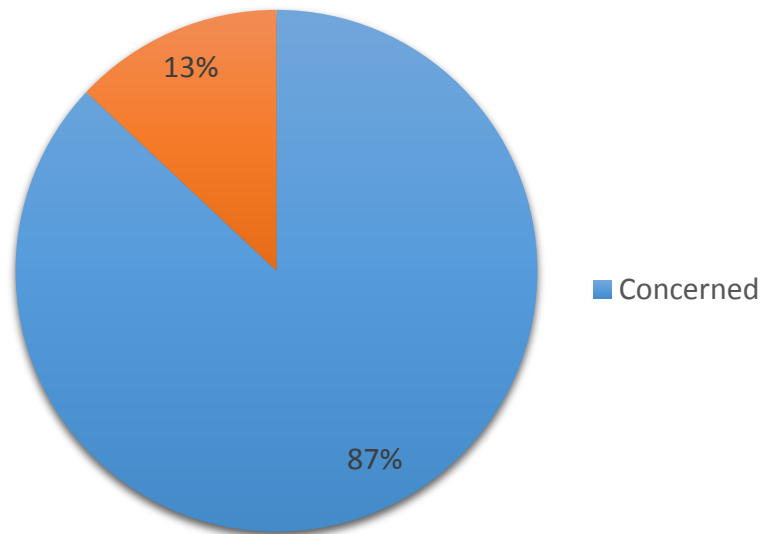
## **IBOR Global Transition Survey & Report**

- Designed to gauge market readiness to transition away from certain interbank offered rates (IBORs) and adopt alternative risk free rates as well as identify challenges and solutions.
- In person interviews and an e-survey questionnaire completed with over 150 market participants from 24 countries.
- Participants included banks, end users, infrastructure providers and law firms.
- Covered wholesale and retail derivatives and cash products referencing LIBOR denominated in USD, Sterling, EUR, CHF and JPY as well as EURIBOR and other Japanese IBORs.

# Overview

## High awareness and positive understanding of RFR Working Group efforts

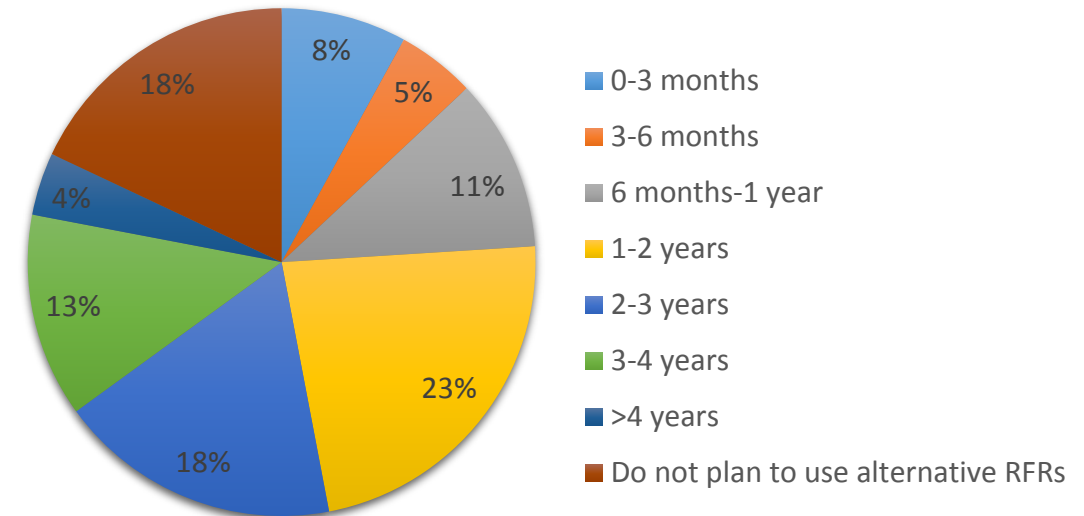
- 87% of respondents were concerned about their exposure to IBORs.
- The majority of participants were familiar with RFR WGs objectives and work output.



## The results indicate that survey participants are gearing up for transition

- 75% have started internal discussions on the transition from IBORs to alternative risk free rates (RFRs).
- 78% intend to trade products which reference RFRs within next 4 years.

### When does your organization intend to enter into new contracts referencing alternative RFRs?



# Key Elements for Transition

Survey participants indicated what they regard as the key elements to successful transition. Many of these are already being addressed by RFR working groups

- **Clear and co-ordinated regulatory messaging and RFR Working Group timelines:**
  - Evolution of desired end state for LIBOR vs TIBOR/EURIBOR
  - Co-ordinated approach to legacy positions across RFR working groups
  - Appetite for more frequent output from RFR working groups, particularly in board/client-friendly format

*RFR working groups have been stepping up the visibility of their coordination efforts and some are launching sub-groups dedicated to communications.*

- **Momentum**
  - 72% of respondents cited wide-scale market adoption of alternative RFRs as critical; and
  - In terms of new RFR products, respondents indicated developing liquidity in the following products would be required to facilitate successful transition:
    - OTC derivatives (>80%)
    - Cash products (67%)
    - Futures (63%)

*Recent progress made with SONIA futures recently launched by ICE and Curve Global and SOFR futures recently launched by CME.*

# Key Elements for Transition

- **Long runways** (particularly EURIBOR).
- **Forward-looking term rates** - 86% of respondents believe forward-looking term reference rates based on RFRs are required for cash products.

*The ARRC, Sterling and EU RFR working groups all have initiatives aimed at producing a forward-looking term reference rate for these purposes.*

- **Development of credit premia** for new transactions referencing RFRs.
- **Tax and accounting alignment**
  - Margin, trading and clearing obligations for non-centrally cleared derivatives;
  - Consumer Protection law
  - Regulatory implications on capital & liquidity ratios

*The RFR working groups have been investigating these issues with helpful messaging, for example, on margin obligations; received from the OSSG, FCA and the ARRC.*

# Implementation Checklist

<b>Assess IBOR Exposures</b>	<b>Assess Impact of Permanent Cessation</b>
<ul style="list-style-type: none"> <li>• Inventory of products linked to IBORs.</li> <li>• Dynamic quantification of net and gross exposure on and off-balance sheet.</li> <li>• Calculate roll-off profiles ahead of 2019, 2020, 2021.</li> </ul>	<ul style="list-style-type: none"> <li>• Review existing contracts and assess fallbacks.</li> <li>• Determine re-papering/client outreach.</li> <li>• Engage with industry working groups to enhance fallbacks.</li> <li>• Mobilize efforts to implement fallbacks.</li> </ul>
<b>Transition Route Map</b>	<b>Mobilization of an IBOR Transition Programme</b>
<ul style="list-style-type: none"> <li>• Contribute to demand for, design of and trading in new RFR products.</li> <li>• Review relevant RFR WG publications, Roadmap etc.</li> <li>• Apply to participate in RFR WGs.</li> <li>• Determine required infrastructure and process changes.</li> <li>• Develop an implementation route map of key projects, milestones and ownership.</li> </ul>	<ul style="list-style-type: none"> <li>• Allocate responsibility to senior executive.</li> <li>• Federate governance structure.</li> <li>• Budget &amp; resourcing.</li> <li>• Project objectives.</li> <li>• Stakeholder education.</li> </ul>

## 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; 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 the relevant alternative risk-free rate (‘RFR’), subject to term and spread adjustments.

Jurisdiction	Working Group	Selected RFR
United States	Federal Reserve Alternative References Rates Committee (“ARRC”)	SOFR
United Kingdom	Bank of England Working Group on Sterling Risk-Free Reference Rates	SONIA
Japan	Bank of Japan Study Group on Risk-Free Reference Rates	TONA
Switzerland	Swiss National Bank National Working Group on Swiss Franc Reference Rates	SARON
Eurozone	European Central Bank Risk-Free Rate Working Group	TBD
Australia	N/A	RBA Cash Rate
Hong Kong	N/A	HONIA

- ISDA will also publish a protocol to facilitate inclusion of the amended definitions (*i.e.*, the definitions with fallbacks) into existing derivatives contracts.

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

- Today 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 will remain open until October 12<sup>th</sup>, 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.



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

The consultation requests feedback 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

# ISDA Benchmark Supplement

- Response to the EU Benchmarks Regulation (Article 28(2)) but drafted globally
- Drafting due to be finished July 2018 with subsequent protocol to incorporate the Benchmark Supplement into new transactions.
- Amends ISDA definitional booklets for interest rate, equity, fx and commodities derivatives to ensure cessation, prohibition or material change of index have robust fallbacks.
- Seeks to leave current triggers and fallbacks unchanged where they are already robust
- Introduces new waterfall for interest rate derivatives: (i) agreement between the parties; (ii) alternative index nominated at trade date; (iii) alternative index nominated by Central Bank or similar; (iv) Calculation Agent nomination; (iv) no fault termination.
- Will be structured to provide interim fallbacks for IBOR trades but will give priority to IBOR fallbacks once implemented.