ISDA® Safe, Efficient Markets

ISDA's Benchmarks Initiatives

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Usage of LIBOR

1) First created for use as a reference rate in pricing syndicated loans but use has expanded over time.

2) The FSB's Market Participants Group (MPG) estimates notional volume of outstanding financial products referencing USD LIBOR to be more than $160 trillion.

3) USD-denominated interest rate swaps represent approximately 90% of this outstanding gross notional.

4) In terms of other USD-denominated products, the MPG estimates that USD LIBOR is used as the reference rate in:

   - 97% of syndicated loans
   - 84% of floating/variable rate notes
   - 71% of collateralized loan obligations

ISDA Global IBOR Transition Survey

Scope of work:

1) Develop a road-map, define a transitional roadmap based on official sector timetables and recommendations and from ISDA fall back rates WG. Completion – end of 2017

2) Draft a report that includes: a) A market survey of the uses of IBORs within wholesale and retail financial contracts; b) The identification of potential issues with transition from a relevant IBOR to an RFR in both existing and new contracts and products, and c) Recommendations as to possible solutions including industry or government led responses Final report published March 2018

3) Scope: 1) broad range of market participants globally, 2) a wide range of products which may reference an IBOR including derivatives, securities financing transactions, securities, loans, mortgages, pensions, insurance products, retail investment products and funds. 3) Focus on IBOR rates relevant to US Dollars, United Kingdom Sterling, Euro & Swiss Franc.

4) Identification of Issues / Solutions: Focus on the transition and recommend ways of increasing the robustness and mitigate the following: a) Documentation issues for both existing and new trades; b) Potential litigations risks and contractual frustration; c) The potential for value transfer and manipulation; d) Threats to market liquidity, market disruption and financial stability; e) Dealing with the credit spread between the relevant IBORs and (near) risk free rates; f) The requirement for term fixings in the future; and g) The requirement for new traded products (e.g. futures) referencing the new rate.

Differentiating Benchmark Initiatives

IBOR Fallbacks

- Led by ISDA at request of the OSSG
- Improve contractual robustness of derivatives referencing an IBOR
- 'Emergency' provisions triggered by the permanent discontinuation of the relevant IBOR
- Fallback to a nominated alternative rate (RFRs) plus a spread
- Spread designed to compensate for lack of IBOR-style bank credit spread in alternative rate.
- Lack of IBOR-style term fixing structure in alternative rate to make fallback effective.

LIBOR Transition

- Led by the Risk Free Rate Working Groups (Public sector-Private sector)
- Selection of nearly risk free rate (RFR) as alternative to LIBOR
- Voluntary transition process during the lifetime of LIBOR.
- For transition of legacy portfolio only, spread may be required to compensate for lack of IBOR-style bank credit spread RFR.
- On-going debate on whether term products need developing for the RFR.

Article 28(2) European Benchmark Regulation

- Led by ISDA for derivatives
- Implementation of IOSCO principles in EU law
- Requires supervised users to plan for cessation or material change of any benchmark (large or small across all products) and reflect in contracts.
- Nomination of alternative rates where feasible and appropriate
- Uncertain scope at present: only if traded on venue or if similar to instruments on venue? What if similar instruments are subsequently traded on venue? Novations into EU?

IBOR Fallbacks – Existing Contractual Language
2006 ISDA Definitions

USD-LIBOR-BBA

- means that the rate for a Reset Date will be the rate for deposits in U.S. Dollars for a period of the Designated Maturity which appears on the Reuters Screen LIBOR01 as of 11:00 a.m., London time, on the day that is two London Banking Days preceding that Reset Date. ***If such rate does not appear on the Screen LIBOR01 Page, the rate for that Reset Date will be determined as if the parties had specified ""USD-LIBOR-Reference Banks"" as the applicable Floating Rate Option.***

USD-LIBOR-Reference Banks

- means that the rate for a Reset Date will be determined on the basis of the rates at which deposits in U.S. Dollars are offered by the Reference Banks at approximately 11:00 a.m., London time, **on the day that is two London Banking Days preceding that Reset Date** to prime banks in the London interbank market for a period of the Designated Maturity commencing on that Reset Date and in a Representative Amount. **The Calculation Agent will request the principal London office of each of the Reference Banks to provide a quotation of its rate**. If at least two such quotations are provided, the rate for that Reset Date will be the arithmetic mean of the quotations. If fewer than two quotations are provided as requested, the rate for that Reset Date will be the arithmetic mean of the rates quoted by major banks in New York City, selected by the Calculation Agent, at approximately 11:00 a.m., New York City time, on that Reset Date for loans in U.S. Dollars to leading European banks for a period of the Designated Maturity commencing on that Reset Date and in a Representative Amount.

ISDA IBOR Fallback Working Groups

ISDA USD Benchmark Working Group

ISDA GPB/EUR/CHF Benchmark Working Group

ISDA JPY Benchmark Working Group

ISDA APAC Benchmark Working Group

ISDA Benchmark Fallbacks Credit Spread Calculation and Term Fixing Sub-group

ISDA Working Group Objectives

1) Identify triggers for fallback rates – ✓ *(see slide 8)*

2) Identify alternative rates – designated by applicable RFR working group or OSSG– ✓ *(see slide 9)*

3) Develop possible methodologies for application of credit spread and term structures for IBOR fallback application – (see slide 10)

4) Amend the 2006 ISDA Definitions to incorporate the fallbacks into new trades

5) Create a protocol to incorporate the fallbacks into legacy trades

ISDA to provide proposed timeline for 3 – 5 above to OSSG in early November

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Triggers

1) A public statement by the supervisor of the relevant IBOR administrator of the insolvency of the relevant IBOR administrator (and there is no successor administrator)

2) 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)

3) A public statement by the supervisor for the relevant IBOR administrator that the relevant IBOR has been permanently or indefinitely discontinued

4) A public statement by the supervisor for the relevant IBOR administrator that the relevant IBOR may no longer be used

Time of trigger: upon cessation of the IBOR (not upon announcement)

Alternative Risk-free Rates as fallbacks

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

Development of Credit Spread + Term Structure for IBOR Fallbacks

Solutions need to be found to compensate for the lack of an IBOR-style credit spread or a term structure in the overnight risk-free rates

Credit Spread Criteria:

- 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 the time the fallback is applied.
- Various possibilities being examined (further suggestions welcomed), each possibility being analysed against the criteria
- Possible methodologies will be adjudicated vis a vis criteria and wide public consultation will choose the final methodology

Term Rates for Fallbacks:

- ISDA WGs have been directed not to wait for term reference rates that might be developed by the RFR Working Groups – the fallbacks need to implemented before they will be ready.
- Limited number of alternatives identified, such as compounding the overnight rate for the relevant period in arrears.
- ISDA will conduct wide public consultation to determine appropriate term rate structure.