ISDA® Safe, Efficient Markets

Understanding the New IBOR Fallbacks – Virtual Event
November 9, 2020

Opening Remarks
Katherine Tew Darras, General Counsel, ISDA

Hello everyone, and welcome to *Understanding the New IBOR Fallbacks*. Thanks for joining us today for this virtual event, and thank you to our speakers.

On October 23, ISDA launched the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol – the culmination of four years' work and a major milestone in the transition from LIBOR.

Fallbacks mitigate the systemic risk that would arise from the cessation of a key interbank offered rate (IBOR) and, as such, they will be absolutely critical in the months ahead. During today's event, we will look at what the fallbacks are, why they are important and how they work.

The value of developing robust contractual fallbacks was crystallized in July 2017, following a speech by Andrew Bailey, then chief executive of the UK Financial Conduct Authority (FCA). In that speech, Bailey said the FCA would no longer compel or persuade banks to submit to LIBOR beyond the end of 2021. For the first time, this set a timetable for the end of LIBOR and turbo-charged industry efforts to actively plan for the transition to alternative reference rates.

Even before that, though, ISDA had started work – at the request of the Financial Stability Board's Official Sector Steering Group – to strengthen contractual fallbacks for derivatives linked to certain IBORs. Since then, we have consulted multiple times on the fallback methodology in order to achieve a broad industry consensus.

As a result of that work, from January 25, 2021, an adjusted version of the relevant risk-free rate will automatically apply if an IBOR ceases to exist or, in the case of LIBOR, is deemed by the UK FCA to be no longer representative of its underlying market.

While fallbacks aren't designed to be a primary means of transitioning from LIBOR and other IBORs, they do mean a critical safety net will be in place for those participants that still have exposure to IBORs when a cessation or non-representativeness announcement is made.

The fallbacks themselves take the form of a supplement to the 2006 ISDA Definitions. Once the supplement takes effect, all new derivatives that reference the definitions will include the new fallbacks. The accompanying protocol will enable market participants to incorporate the revisions into their legacy non-cleared derivatives trades with other counterparties that also adhere to the protocol. Both the supplement and the protocol will take effect on January 25, giving the industry another two-and-a-half months to prepare.

So far, signs are very positive. During a two-week escrow period prior to the official launch on October 23, 257 entities across 14 jurisdictions adhered to the protocol on a binding but non-public basis. As of today, that number stood at more than 470, including most of the major banks and many buy-side firms.

We are confident that adherence will continue to increase as we approach January 25, and our panels today and tomorrow will give you all the information you need to understand the supplement, the protocol and the fallback rates themselves.

Now, fallbacks are critical not only as a means of mitigating systemic risk, but also as a milestone in the broader benchmark reform process. With robust fallbacks in place, market participants should have greater confidence and capacity to focus on voluntary transition. There are now less than 14 months to go until the end of 2021, so building momentum and liquidity in alternative rates is a priority for the whole market.

There has been progress on this front. The ISDA-Clarus RFR Adoption Indicator, which tracks interest rate derivatives trading referencing risk-free rates in six major currencies, jumped from 6.4% to 9.5% in September. Trading referenced to SOFR is understood to have increased further in October after central counterparties switched to SOFR for price alignment interest and discounting. However, there is still a way to go.

In our new podcast, *The Swap*, we recently published a three-part series on benchmark reform, including an episode on efforts to build liquidity in risk-free rates. If you haven't had a chance to listen, all three episodes are available on our website, on Spotify or on Apple podcasts.

Given the complexity of replacing LIBOR and the other IBORs with alternative rates, collaboration between the public and private sectors has been critical. Working groups in key jurisdictions have been very effective in setting targets and timelines and tackling challenges.

In the US, the Alternative Reference Rates Committee (ARRC) was convened in 2014 by the Federal Reserve Board and the New York Fed, and has led the industry through the launch of SOFR with a paced transition plan that sets out specific steps to encourage the adoption of SOFR.

For our first session today, we're delighted to welcome Tom Wipf, vice chairman of institutional securities at Morgan Stanley and chair of the ARRC, together with Nate Wuerffel, head of domestic markets in the markets group at the New York Fed. Tom and Nate will participate in a virtual fireside chat hosted by ISDA's CEO, Scott O'Malia.