

Mr Scott O'Malia, Chief Executive Officer  
Mrs Katherine Tew Darras, General Counsel

International Swaps and Derivatives Association  
10 East 53rd Street 9th Floor  
New York, NY 10022

By email

Dear Mr O'Malia and Mrs Tew Darras

## **Derivative contract robustness to risks of interest rate benchmark discontinuation**

We are writing as Co-chairs of the Financial Stability Board's Official Sector Steering Group (OSSG) of regulators and central banks. On behalf of the OSSG, we would like to thank ISDA for its engagement and work so far, pursuant to the OSSG's request of 7 July 2016, in consulting on options for adopting more robust fallback language for derivatives referencing key Interbank Offered Rates (IBORs). The measures that ISDA is taking will play a very important role in the transition from LIBOR and will serve to strengthen contract language in derivatives referencing other IBORs. The adoption of appropriately revised fallbacks by market participants will help to mitigate a key source of risk to the financial system.

We welcome the very thoughtful and comprehensive responses that ISDA has received from market participants in its consultation for sterling LIBOR, Swiss franc LIBOR, Japanese yen LIBOR and TIBOR, and the Australian dollar BBSW. As ISDA now moves towards its final decisions for these currencies with this feedback in hand, we wish to raise three issues that the OSSG views as particularly important and that we believe ISDA is moving to address:

- the addition of other trigger events;
- the timing for an ISDA consultation on U.S. dollar (USD) LIBOR and certain other IBORs;
- the governance and transparency necessary as ISDA makes its final decisions.

### *Additional trigger*

We would like to encourage ISDA in its recent determination to ask for market opinion on the events that would trigger a move to the spread-adjusted fallback rate. Triggers that would only take effect on the date on which LIBOR permanently or indefinitely stopped publication could leave those with LIBOR-referencing contracts still exposed to a number of risks.

As you heard at the meeting with the OSSG in November last year, OSSG members ask that ISDA also consult on including an additional trigger that would take effect in the event that the Financial Conduct Authority (FCA) found LIBOR to be non-representative in its capacity as

the regulator of LIBOR. The EU Benchmark Regulation requires FCA to make an assessment of representativeness in certain circumstances, such as the departure of one or more panel banks, or in any event every two years. While the Benchmark Regulation envisages some circumstances in which a critical benchmark that does not meet requirements of the Regulation (such as representativeness) continues to be published to avoid a disruptive cessation and potential financial instability, force majeure events or frustration of contracts, it also envisages that EU supervised entities would no longer be able to enter into new derivative or securities transactions referencing LIBOR in those circumstances. This would diminish liquidity in LIBOR-based derivative contracts and hence the usefulness to most market participants. Without a trigger for this event included in the ISDA definitions, market participants could find themselves forced either to continue using LIBOR in legacy contracts within a severely disrupted market or agree bilaterally on terms at which they could close out across a wide array of contracts and counterparties, which would likely be difficult.

Such a trigger would offer market participants with LIBOR-referencing derivative contracts the opportunity to move to new benchmarks rather than remain on a non-representative LIBOR rate, or possibly even a LIBOR rate that reverted to a fixed rate under current “reduced submissions” policies.

There is also a widely-held desire amongst market participants to seek the closest possible harmonisation between fallbacks for derivatives and cash products. We note that the Alternative Reference Rates Committee (ARRC) has included a trigger of this form in its consultations for cash products referencing USD LIBOR, and that respondents to the first two of the ARRC’s consultations have expressed support for this.

For other IBORs in scope of the consultation, we request that ISDA engage with the relevant authorities for the currencies on whether to include such an additional trigger for those IBORs.

#### *Timing of the consultations for USD LIBOR and other IBORs*

There is an estimated USD 200 trillion in exposure to USD LIBOR, making it by far the most widely used of the LIBORs. We understand that ISDA intends to consult on USD LIBOR, CDOR, HIBOR and SOR in early 2019, and the OSSG strongly supports this. We believe that the clear preference by respondents for use of the “historical mean” method of calculating a spread adjustment in the currencies consulted on by ISDA thus far could be quickly implemented for USD LIBOR also if this method was supported in a second consultation. In relation to EURIBOR and EUR LIBOR, ISDA is invited to coordinate with the relevant NWG (the EUR RFR WG) to identify the best moment in which ISDA should issue a dedicated consultation on EURIBOR and EUR LIBOR.

#### *Governance and transparency*

The importance of this work is such that a careful process of assessment and consideration is essential before the publication of outcomes. We know that you also attach importance to this, and we recognise that the consultation outlines steps and processes by which ISDA will make its determination, and that your plans include engagement with the OSSG at regular intervals before any publication. We welcome this, and in addition to consultation with market participants, encourage you to build into your plans engagement with the relevant authorities for the currencies in scope of the consultation. It is equally important to ensure transparency around how ISDA’s Board and/or Benchmark Committee would arrive at its decision.

In this regard, we encourage ISDA to consult both on the addition of the third trigger that we have indicated we believe could benefit market participants and on the key technical details that ISDA’s Board Benchmark Committee will need to decide on before implementation can begin

(including the parametrisation of the historical mean/median look-back, and the details of how the credit spread will be calculated and applied over the compounded rate).

We continue to appreciate the work that ISDA is leading with regard to enhancing contract robustness.

Yours sincerely,

Handwritten signature of Andrew Bailey in black ink.

Andrew Bailey  
Chief Executive Officer  
UK Financial Conduct Authority

Handwritten signature of John Williams in black ink.

John Williams  
President and Chief Executive Officer  
Federal Reserve Bank of New York