

Considerations around credit spread adjustment options in ISDA consultation on fallback rates

In their previous meeting on 20 August 2018, the Working Group on Sterling Risk-Free Reference Rates (the 'Working Group') agreed that it may be helpful to publish a set of considerations to assist market participants in assessing each of the three proposed methodologies for the credit spread adjustment in the ISDA consultation on fallback rates¹.

ISDA has noted in the consultation that firms should consider a range of criteria under which the potential approaches to the credit spread can be assessed. In particular it noted that firms should take into account if it was possible to eliminate or minimise the potential for manipulation and for market disruption, and to eliminate or minimise any value transfer at the time the fallback is applied.

The consultation also suggests that when considering the methodologies and answering the questions posed, respondents should determine for themselves how to weight each criterion and "may also want to consider their own additional criteria."

In support of the ISDA consultation, the Working Group therefore felt there would be value in providing - for information only - some potential considerations and additional criteria to assist market participants when responding to the consultation.

In terms of the criteria set out by ISDA, the Working Group notes that respondents may wish to consider - and quantify - the extent of any value transfer (e.g. present value implications, accrual), and any other relevant metrics, at different points in time.

Respondents may also wish to consider whether the underlying data inputs needed to support each option are over time available, reliable and robust (including against manipulation). Finally, respondents may also wish to consider the benefits and drawbacks of bounding the range of potential outcomes.

The Working Group also contemplated potential additional criteria which could be helpful to consider. Factors such as transparency, practicality and the extent to which options would help to facilitate global transition away from a range of relevant IBORs are likely to be important.

In the context of these factors, respondents may also wish to consider the extent to which a proposal would be easily understood by others within – and beyond – markets. The following considerations could likewise be judged to be important: a) the practicality of implementing different proposals in terms of documentation updates; b) the implementation of the methodology; c) the ease of calculation; d) the implications for consistency; and e) impacts on other markets.

Finally, the Working Group takes the opportunity to emphasise the importance of a wide range of market participants contributing to the ISDA consultation process.

This statement is not necessarily endorsed by the FCA and Bank of England. Market participants are free to have regard to any criteria they feel appropriate and to weight them as they see fit. Respondents should arrive at their own conclusions when responding to ISDA.

¹ <http://assets.isda.org/media/f253b540-193/42c13663-pdf>