

February 2013

EBA/ESMA – Consultation paper – Principles for Benchmarks-Setting processes in the EU

ISDA response

Introduction

On behalf of our members, ISDA appreciates the opportunity to respond to this consultation, with the goal of contributing to a robust and stable financial market. In this response, we have limited ourselves to commenting on those issues that are directly relevant to ISDA and OTC Derivatives Markets. There are, of course, many important issues discussed in the consultation document that go beyond that scope, and we defer, in relation to those issues, to other financial market respondents with greater expertise and/or a more relevant focus. Equally, we will not address considerations of possible alternatives or successors to any rates/indices (e.g. Libor or Euribor), either generically or specifically, in the case of those that we are aware will already be discontinued or those where a decision is yet to be made for the discontinuation.

Our responses to selected questions where ISDA does have a comment can be found in full in the accompanying Annex 1. **Our submission addresses ISDA concerns around financial benchmarks (eg benchmarks in the interbank market, including LIBOR) unless our response explicitly states otherwise, for example where we comment on the treatment of oil price reporting agencies (PRAs).**

HIGHLIGHTS

- In relation to any **transition** to alternative benchmarks, there should be clear and long term arrangements in place. Failure to achieve a smooth and progressive transition will result in major market dislocation and significant “jump risk” if there is an abrupt move from old benchmarks to a successor. The rate of any transition will likely be chiefly determined by the speed of migration to an alternative in terms of liquidity, as well as the extent to which market participants have amended their documentation.
- Regarding a **hybrid methodology** for calculation purposes, we generally support the use of actual trade data (where available) in benchmarks’ compilation. At the same time, we believe that it will still be necessary to deploy algorithms or expert judgment to fill the gaps where no trade data exists. In fact, we would argue that expert judgment still plays a part even where actual trade data exists, given that the decision to transact the trade(s) in practice depends upon the exercise of such expert judgment.

- ISDA developed **ISDAFIX** to facilitate the determination of exercise values for cash-settled swap options. The existence of such a benchmark provides a transparent, readily available value to which parties to a transaction can refer as a settlement rate. Without such a benchmark, it might be necessary to go through the process of calling a number of active dealers for quotes in order to settle transactions. For more information on ISDAFIX and other benchmarks used by ISDA members please refer to Annex 2.
- ISDA encourages EBA/ ESMA to take account of the distinction between key **public benchmarks** that are primarily used for purposes of pricing a broad range of financial instruments or contracts and benchmarks in the broader sense (including **proprietary indices**). In short, not all indices should be regarded as “public goods” and this should be reflected in the design of any regulation. **There is not a one size fits all approach**. Considerations need to be taken into account as to who is contributing to a rate and who is ultimately using the rate, and an informed assessment needs to be made as to what is appropriate.
- In relation to future reforms, there should be alignment with **existing regulatory initiatives and proposals should be co-ordinated on a global basis to reflect the markets they relate to**. Particularly, if transactions are to be reported, then existing reporting databases, systems and reporting routes should be leveraged.
- Regarding commodity derivatives, many benchmarks are important for the functioning of the markets. Exchange-traded benchmarks including CME/ NYMEX, ICE and CRB as well as benchmarks of price reporting agencies, are used to price physical markets and, indirectly, derivatives and hedging instruments. In this respect, ISDA would like to make some general points regarding commodities markets:
 - Physical indices have a degree of subjectivity for two primary reasons: (1) the absence of standardisation in physical qualities requires an assessment of value; and (2) the fact that certain physical oils may not trade continuously, requires an assessment of where value is likely to be;
 - The physical markets reflect the supply/demand fundamentals, and financial markets derive prices from there - not vice versa.
- Regarding more specifically PRAs, ISDA supports the work that has been done by IOSCO on self-governance.

We have pleasure in submitting our responses, and look forward to staying very much engaged with EBA and ESMA as regards future initiatives on this topic.

Yours faithfully,

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ANNEX 1: RESPONSES TO CONSULTATION QUESTIONS

Question 1: Definition of the activities of benchmark setting

Do you agree with the definitions provided in this section? Is this list of activities complete and accurate?

We generally agree with the definitions.

However, the Commission's proposed definition of benchmark is very broad, capturing 'any commercial indices' and raising a number of issues relating to enforcement. In particular, we would encourage clarifying the scope of the term benchmark to appropriately capture published, widely available benchmarks, as the current definition (in the Commission proposal) would capture all proprietary indices (firm sponsored, private indices) and there should be a regulatory distinction between firm sponsored 'private' indices and survey based 'public' indices in terms of the level of governance required. Some of our members publish thousands of indices and a protocol that may have been drafted from the perspective of survey based public indices may not be appropriate for all benchmarks. One suggestion would be for ESMA to develop a list of widely circulated / used benchmarks in Europe.

While we would support that all benchmark sponsors should be cognisant of future regulation on benchmark governance when designing a controlled environment, it should be proportionately applied depending on the nature and significance of a particular benchmark. Our members are mindful of the need for adequate systems and controls and feel that by retaining more flexibility, they can ensure governance is proportionate to the risks of the business. Requiring adherence to future regulatory arrangements for 'any commercial indices' is likely to be impractical, costly and potentially disproportionate to their market significance.

Therefore, with respect to 11.i (definition of 'benchmark') we:

- would very much welcome further clarity on the meaning of 'commercial';
- suggest that 'any commercial index or published figure' should be amended to 'any commercial index or published figure that is intended to be used as a benchmark'. Otherwise, a much broader range of figures will be caught than we believe is appropriate or intended.

Please also see the response to Questions 2 and 3, the sections on scope, proprietary and public indices, and methodology (data).

Question 2: Principles for benchmarks

Would you consider a set of principles a useful framework for guiding benchmark setting activities until a possible formal regulatory and supervisory framework has been established in the EU?

ISDA supports sound appropriate oversight and transparency of financial benchmarks, and therefore sound tailored governance rules applied to entities responsible for benchmarks. Suitable transparency of methodologies and independent oversight of these methodologies is needed to ensure confidence in the markets.

There is not a one size fits all approach. Considerations need to be taken into account as to who is contributing to a rate and who is ultimately using the rate, and an informed assessment needs to be made as to what is appropriate.

To repeat, ISDA also encourages the regulators to take account of the differences between key public benchmarks and benchmarks in the broader sense (including proprietary indices). In short, not all indices should be regarded as “public goods” and this should be reflected in the design of any regulation.

We welcome policymakers’ steps to ensure international coordination and alignment of regulatory/principles changes which relate to international markets.

Please also see the response to Question 3 and 1.

Question 3: General principles for benchmarks

Do you agree with the principles cited in this section? Would you add or change any of the principles?

General principles, governance, transparency

ISDA agrees that a general framework for financial benchmarks should address methodologies, governance structure, supervision, transparency and continuity.

We however do not consider that there is a solution that would work for every benchmark. Each benchmark should be assessed on its own merit and suitable procedures put in place.

We also would like to highlight that governance and the application of regulation should always be considered on a careful assessment of the associated costs against the expected resulting benefits. Market impact of the index or benchmark is a further important factor and it is clear that many index/ benchmark prices are important for the functioning of the markets.

Concerning governance, we believe the following related criteria to be important:

- Appropriate seniority of and responsibility of staff (so less open to being influenced);
- Complaints process – need for a framework for raising concerns (independent of benchmark contributors);
- Appropriate consultation with users on changes;
- Systems and controls which lead to reliable daily operations;
- Transparency of methodology, of operation and application of any judgement.

Scope

We would like to highlight the following points regarding the existing financial benchmarks that are used in the markets.

Some ISDA members regularly produce customized indices that are used for pricing bespoke bilateral or similar transactions among a limited number of counterparties. We note in many cases that these customized indices could fall under the definition of benchmarks used in the consultation, though we believe it could be appropriate to exclude them. Examples would include customized or

privately-negotiated indices, reference portfolios or baskets, defined in connection with specific issuances of structured notes, with bespoke transactions to effect investment strategies, or with similar bilateral or limited arrangements. The indices or baskets come in many forms and are in many cases subject to product regulation as a result of the products with which they are used. In some cases the indices or baskets are more connected with the products they are used with and are not free-standing benchmarks which could be separately regulated.

In our view, a regulation should consider the function of a particular benchmark (governance, controls, management, conflict of interest, etc.). In respect of proprietary indices, we believe that adequate regulatory protections already exist, reflected in a number of pieces of European legislation:

- MiFID rules on suitability and appropriateness and on the management of conflicts of interest;
- Recently enhanced Prospectus Directive disclosure provisions relating to indices; and
- Recently enhanced UCITS provisions on the eligibility of a particular index.

Given that proprietary indices are today already subject to a number of governance mechanisms, the main consequence of additional rules in respect of proprietary indices (e.g. the mandatory use of third party calculation agents) beyond governance arrangements already in place would be to increase costs borne by the end investor or otherwise reduce investor choice, without advancing in a meaningful way the level of protection provided to the investor.

ISDA also encourages the regulators to take account of the differences between key public benchmarks and benchmarks in the broader sense (including proprietary indices). In short, not all indices should be regarded as “public goods” and this should be reflected in the design of any regulation.

In particular, proprietary indices used by ISDA members are designed to help particular clients implement specific investment strategies or achieve particular investment objectives, rather than to capture or approximate a transaction (e.g. the cost of borrowing in the interbank market, in the case of Libor). Therefore, the policy measures that may be applied to public benchmarks are unlikely to be appropriate for private indices. For example, the level of transparency that might be expected of a public benchmark could not readily be extended to private indices, which essentially constitute intellectual property, without undermining the ability of firms to offer their clients products that offer specific exposures in a cost-effective manner. As noted above in many cases these indices are already subject to product regulation, including disclosure requirements in legislation such as the Prospectus Directive or UCITS legislation.

Please also see the response to Q 1 and 2.

Appropriate framework for guiding benchmark setting activities, supervision

We would like to reiterate that governance and the application of regulation should always be considered on a careful assessment of the associated costs against the expected resulting benefits. Market impact of the index or benchmark is a further important factor and it is clear that many index/ benchmark prices are important for the functioning of the markets. To give one example, IOSCO has considered this balance in its review of oil price reporting agencies, in which it recommended that appropriate protections and governance are put in place through self-regulatory principles for PRA benchmark governance. PRAs are thus encouraged to comply subject to independent audit. If satisfactory compliance is not achieved, then other policy instruments, including applying a form of regulation of PRAs should be applied.

Index providers fulfil a high impact and critical role in many markets and as an association of market users, we support any measures designed to ensure that appropriate standards are achieved, provided these can be justified on a cost benefit basis.

We consider regulatory burdens relating to index/benchmark production should primarily fall on the provider of the benchmark, as it has primary control over and responsibility for the final price publication. Many participants who submit to indices/ benchmarks are regulated firms themselves, so extension of regulation to further activity represents additional incremental cost. Again, we consider that any such extension should be considered on a cost-benefit basis. Benchmarks/ indices provide essential transparency to markets and it is important not to impose regulatory burdens which may deter legitimate participation in these processes.

Regulatory reporting of benchmark submissions should leverage existing trade capture and reporting routes already used by many market participants for their existing trading and/ or regulatory reporting activities.

In brief, we see the following advantages and disadvantages of making benchmark setting a regulated activity:

Disadvantages:

- Associated cost for both administrators and submitters,
- Firms may consider the risks and costs associated with contributing to be too onerous, and a consequent reduction of liquidity could damage assessment of what are in many cases already relatively illiquid markets.

Advantages:

- Controls would be tighter.

Methodology – general remarks

We agree with the principles cited but we strongly believe that it should be acknowledged that in practice, these cannot always be adhered to. In particular, with regards to A.1 (Methodology) - specifically liquidity of the underlying - it should be noted that liquidity can vary over time and therefore benchmark setting rules should vary accordingly. For example, relatively new markets are likely to be less liquid; the requirement for the underlying to be 'sufficiently liquid' could undermine their development. These points are relevant especially in the context of emerging markets. We believe that where there is a lack of data, the benchmark administrator should provide guidance on how to get over a transition period.

Methodology – data

Regarding a hybrid methodology for calculation purposes, we generally support the use of actual trade data (where available) in benchmarks' compilation. At the same time, we believe that it will still be necessary to deploy algorithms or expert judgment to fill the gaps where no trade data exists. In fact, we would argue that expert judgment still plays a part even where actual trade data exists, given that the decision to transact the trade(s) in practice depends upon the exercise of such expert judgment.

Regarding ISDAFIX, a benchmark based on a mid-day and, in some markets, end-of-day polling of mid-market rates. ISDA members also make use of other benchmarks, although ISDA is not responsible for the maintenance of those benchmarks, or the methodology that underlies them.

Concerning other indices, many ISDA members maintain proprietary indices to help track the performance of a particular asset class or sector, and potentially to determine the pay-off on structured products, including exchange-traded funds (ETFs), notes, certificates and warrants. A

proprietary index might reference a basket of securities relating to a particular sector or market (a basket of emerging market securities, government debt, corporate debt), or physical assets, such as commodities (precious metals, energy resources, for example), or a combination of asset classes and sectors. Typically the value of such indices is derived from market data on its constituent assets, collected and weighted according to the documented, rules-based methodology of the index. The internal governance structures designed around the development of these proprietary indices may require the calculation, or at least the verification, of the levels of such indices by independent third parties. The existence of such indices allows an investor to gain exposure to a given sector or class of assets (i.e., making it easier to gain exposure to multiple reference assets), whilst avoiding many of the difficulties and costs associated with arranging a direct investment in the underlying reference assets.

In relation to wholesale energy markets, indices and benchmarks produced by PRAs are based on actual transaction data, on bids and offers and on opinion obtained from market participants, in that order of preference, consistent with a PRA's approach to ensuring the quality and integrity of a price assessment.

Finally, we acknowledge that there is a tension where indices rely on voluntary contributions, though we believe that if powers to compel participants in financial markets to make submissions to benchmarks exist, they should only be used as a last resort, and where there is a significant risk of widespread disruption. Some thought should be given to the question as to which body would have power to compel an entity to make a submission to a specific index.

If powers to compel participants in financial markets to make submissions to benchmarks are exercised, it is important that such participants can benefit from "safe harbors" for so long as they act within the scope of the rules of the relevant index.

Continuity - contingency

Benchmark rates should have specific, transparent and published processes, as appropriate, detailing how the final published rate is calculated. If deemed suitable, specific measures could be set out detailing if any sort of contingency plan could be invoked in the case of, for example, severe local circumstances which would prevent a rate from publishing per the standard fixing methodology. An example of this would be in the case of a benchmark which is fixed via a calculation based on a number of panel bank submissions, but fixes only when a minimum level of contributions are received within a certain timeframe. A contingency plan could involve extending the usual window for submissions, lowering the minimum level of contributions required, etc. We consider it essential that any sort of contingency plan is transparent and should only be invoked per the stated definition.

Question 4: Principles for firms involved in benchmark data submissions

Do you agree with the principles cited in this section? Would you add or change any of the principles?

We strongly support an appropriately transparent methodology for sourcing rates in the case of a rate derived via a panel of contributor firms. Rate definitions should be tightly worded as to how and where contributed rates should be sourced, and alternative rate generation processes should be provided when the preferred method is unavailable or unreliable at any point. Where possible, and provided it is deemed appropriate for a specific rate, we would support the use of live/executable prices, based on a standard contract size. A standard contract size would be determined based on the specifics of each market and the nature of the benchmark to be published.

We would also like to highlight the need to ensure that regulation and the compliance burden are proportionate. It should be recognised that the imposition of costs above a certain level will weaken further the incentives for and capacity of institutions to produce benchmarks to the point that they may become prohibitive.

We would also suggest that the following points be taken into account:

With respect to B.8, although 'controls performed on the data submitted should include comparisons with actual, transaction-based, verifiable data'; it should also be acknowledged that comparison with actual transactions can be difficult in cases of low liquidity.

With respect to B.11, we believe that the key point is that the confirmation of compliance with the relevant principles should function as a clear and robust process based on communication with the relevant competent oversight body, rather than be based on a vague public disclosure process.

In the specific context of Oil PRAs, it is also crucial that they have a robust dispute resolution and transparent complaints processes, based on IOSCO principles.

Question 5: Principles for benchmark administrators

Do you agree with the principles cited in this section? Would you add or change any of the principles?

Generally speaking, ISDA supports suitable transparency of methodologies used by entities responsible for financial benchmarks.

In particular, concerning C.2, to ensure that any potential conflict is appropriately mitigated it might also be appropriate that the governance compliance function is independently chaired. At the same time it is equally important that there is sufficient expertise within this function.

Regarding C.3, we are concerned with the phrase 'so that judgement and qualitative assessments or other opportunities for discretionary decision making are limited as much as possible.' We submit that the proposed rules must instead recognise explicitly that expert judgement is or may have to be exercised in submissions to a benchmark rate in the circumstance where there is an absence of sufficient relevant transactional data as a reference point.

With respect to C.8, we would welcome clarity on to whom this information should be posted. We believe that a clear communication process with an appropriate oversight body should be the key element here.

In the specific context of oil PRAs, ISDA sees the need for transparent methodologies especially in relation to the substantial discretion exercised in their implementation; there should be a formal complaints process and an adequate compliance function. Today price assessments essentially operate under governance procedures which may be somewhat opaque and which can result in a subjective approach, where there is no appeal process in respect of subscribers' price contributions.

We therefore strongly advocate that PRAs must establish a clear and unambiguous framework, including methodology and formulas, all of which are transparent to the subscribers and objectively applied, based on the IOSCO principles.

Question 8: Principles for users of benchmarks

Do you agree with the principles cited in this section? Would you add or change any of the principles?

We agree with the principles although, with respect to F.2 we believe that the requirements for distributors appear to be greater than are proportionate. Whilst the distributor should be responsible for ensuring that the benchmark used is appropriate, suitable and relevant for the target market – as outlined in F.1 - the responsibility for whether the benchmark itself is functioning properly should lie with the administrator.

In making this comment, we assume that the principles apply to the distributor. If this is not the case and they are intended to require end users to ensure that the benchmark administrator and calculating agent are compliant, we suggest that this will be unfeasible in practice. Instead, ensuring that the benchmark administrator and calculating agent are compliant should be subject to independent oversight as appropriate.

We agree with the point F.4. At the same time we would like to highlight that we fully agree with paragraph 30, which states that any change to a benchmark's framework (calculation methodologies and procedures) should be managed so as to ensure that any disruption to existing benchmark-referenced contracts are minimised.

In relation to derivatives, some of the most important factors for users to take into account when choosing a reliable and appropriate benchmark would be liquidity of the underlying; as well as high transparency of benchmark development and changes; good governance (i.e., a single, identified authority with specific accountability for the sound operation of the benchmark); and a methodology which suits the underlying. For physical market benchmarks, confidence is more likely to develop where underlying infrastructure is not controlled by any one or a small number of market participants. Also, political stability and transparency of government in the relevant jurisdiction can be key elements to fostering development of effective benchmarks in some cases.

Question 9: Practical application of the principles

Are there any areas of benchmarks for which the above principles would be inadequate? If so, please provide details on the relevant benchmarks and the reasons of inadequacy.

Yes – for example where there is a lack of liquidity or a proprietary benchmark is concerned (please see our points under Questions 1, 2 and 3).

Question 10: Continuity of benchmarks

Which principles/criteria would you consider necessary to be established for the continuity of benchmarks in case of a change to the framework?

In general, regarding market movement between a benchmark and its replacement, ISDA believes that there should be clear and long term arrangements in place to manage any transition to alternative benchmarks. The general procedures put in place to govern any changes to methodology and transition must allow for practitioner consultation and input. A review schedule should be agreed to by all involved parties, including users of the benchmark. Suitable notification procedures

should be put in place. The rate of any transition will likely be chiefly determined by the speed of migration to an alternative in terms of liquidity as well the extent to which market participants have amended their documentation. We think that individual benchmarks should be assessed on their own merit. We do not think that there is a solution that would work for every benchmark. We also encourage policymakers to ensure international coordination and alignment of changes which relate to international markets. Failure to achieve a smooth and progressive transition will result in major market dislocation and significant “risk” if there is an abrupt move from old benchmarks to a successor.

We would like to highlight that in order to avoid market disruption, it is in particular imperative that there is legal certainty as to the continuity of existing contracts referencing the benchmark. Without this legal certainty, those involved in the benchmark-setting process may, inadvertently, become subject to legal claims as a result of the changes to a contract. We have set out some of these issues below. We would welcome the opportunity to work further with the authorities on how this could be taken forward.

In particular, in this response, we have limited ourselves to providing detailed comments mainly regarding the challenges created by a transition to future contracts from contracts relying on **Libor** or other benchmarks in the interbank market.

As the trade association for OTC derivative products, our comments below relate solely to those products, whilst recognising that changes to Libor or a transition away from it will also impact other products in other markets which often underlie **OTC derivatives transactions**. Within the OTC derivatives markets, interest rate derivatives are the most heavily impacted asset class. We offer some detailed analysis of how trades might be affected by changes to or a move from Libor, according to the terms of their ISDA documentation and in the wider context of incident legal risk.

The majority of OTC interest derivatives transactions use Libor rates as the reference rate for floating legs of transactions. These transactions are typically **documented** under an **ISDA Master Agreement and a trade Confirmation**, which will reference the relevant published **ISDA Definitions**. The Definitions give formal and detailed descriptions for all of a transaction’s variables that will be referenced in the trade Confirmation. In other words, the Definitions remove the need to restate the often lengthy descriptions of commonly-used trade attributes in Confirmations. This has an important risk reducing effect in that it enables rapid (often electronic) turnaround times, given that the Confirmations can be brief in that they refer to, rather than restate the Definitions. The main operative booklet of definitions with respect to Libor is the “2006 ISDA Definitions”.

In essence the definitions of Libor rates are very much **page-driven**, by which we mean that the rate for (say) GBP Libor is defined as being the rate that appears on Reuters screen LIBOR01 (or an equivalent page in the case of the Bloomberg definition). Defining the rates in this way means that the Definition should be able to accommodate a certain amount of change to the rate in terms of methodology of compilation, for instance, so long as the rate still appears on the given page.

Clearly, however, there are limits to this and as **changes** become more economically significant, and to the extent that Libor is fundamentally changed into something else (even if its description does not change and even if it continues to fall within the strict wording of the definition), so the risk increases that parties may claim, under doctrines of frustration or otherwise, that the contract is not what they bargained for. The definition provides that where the rate is not published at all, parties will revert to the polling of specified numbers of so-called “Reference Banks” to arrive at a rate themselves.

ISDA member firms support the final **proposals the BBA** has made in terms of the currencies and maturities of LIBOR that will be discontinued.

Of the 5 **currencies** to be discontinued, ISDA only publishes definitions for the AUD and CAD rates. Parties using any of the other 3 rates will presumably have had to define these rates in their own bespoke documentation and would need to act in accordance with its terms in the event of discontinuation. That said, we suspect trade volumes here to be very low. With respect to AUD and CAD, data from the DTCC Global Trade Repository indicates there is only a handful of extant trades, meaning that the Reference Banks fallback should work effectively i.e. that firms should be able to conduct polls, albeit manually, in order to calculate a rate, or else firms can bilaterally agree an alternative, suitable local rate to use.

The discontinuation of the specific **maturities** presents more of a problem, as we believe the outstanding number of trades to be such that the market would not be able to support a trade by trade solution. In addition, the “Reference Banks” mechanism for determining rates for discontinued maturities faces the same issue that the Wheatley Review is looking to resolve, i.e. no transaction data to corroborate submissions. This essentially means that the industry needs to seek a solution to deal with this effectively.

The problem that exists is that the majority of confirmation documents are unlikely to specify the use of interpolation for trades with discontinued maturities. The only way to legally change a confirmation retrospectively is for the parties to agree to that amendment. Agreeing and affecting such amendments bilaterally would be cumbersome, but ISDA could facilitate this process by publishing a **protocol**, which firms would need to adhere to in order to amend their contracts with the other parties. This would be a voluntary process and both parties would need to adhere to the protocol for it to be useful. ISDA continues to assess the market impact of the maturities and currencies to be discontinued, and is working with the industry to agree a solution to minimise market disruption.

Should discontinuation be considered for **other benchmarks in the interbank market** a few general issues need to be taken into account. An initial obstacle here in the interbank market will be that the parties will need to agree upon which **Reference Banks** to approach, if this is the defined or agreed fallback, should a benchmark no longer be available. Once agreed, polling can take place, however it is possible that strictly speaking thousands of polls may need to be conducted on a trade by trade basis and it is highly unlikely the market could support this burden of activity. Even if all the polls were conducted in a timely and orderly manner, each would yield a different result. This would mean that a party with (say) 2 resetting trades with 2 banks would see those trades reset at different levels.

Changes would be required to the standard ISDA **documentation** to give effect to changes, once their details were known, or to address the consequences of the outright discontinuation of an interbank rate, both in respect of the “back book” of legacy trades and to cover new trades on a going forward basis. The market would need to migrate to a successor rate or rates (pre-existing or otherwise) in respect of each rate that was discontinued, be that a more minor rate such as AUD or a major one such as GBP. ISDA could publish Supplements to its Definitions to facilitate changes to contracts necessary to reference any newly-published successor rates.

To facilitate the use of successors in legacy trades, ISDA would likely publish a **Protocol** which would have the effect of amending OTC derivatives contracts between adhering parties so as to convert their back book trades to reference the agreed successors. It would be absolutely vital to have clear and long term transition arrangements in place, given that the market will take time to migrate

liquidity to new rates. It is important to note that adherence to an ISDA Protocol is entirely voluntary, and market participants will only adhere if they perceive that it is in their interest to do so. For the Protocol to be as effective as possible a significant period of time is required so that as many market participants as possible can participate, and can have the opportunity to do so as they see liquidity migrating to the new rate sources. Without such transition arrangements, the ensuing market disruption could be potentially unmanageable.

We have mentioned the **risk of claims of contractual frustration** a number of times, and now turn to cover this in more detail in the context of OTC derivatives portfolios covered by English law-governed ISDA Master Agreements. As suggested above, there is likely to be something of a continuum from minor changes that could most likely still be regarded as falling within the existing definitions of the floating rates, through to more significant changes that could lead some market participants to claim under doctrines of contractual frustration or otherwise, that the nature of their contract had changed fundamentally from what they had originally intended. It is certainly unclear at which point one becomes the other, and we hope that changes could be managed in such a way that it is not tested.

Under the English law doctrine of frustration a contract may be discharged if broadly speaking, after its formation supervening events occur which have the effect of either (i) frustrating the contract's commercial object or purpose or (ii) making its performance impossible. It is unclear whether major changes to a rate, or its discontinuation, would be grounds for a valid claim of frustration or under some other doctrine but it will be clear those changes to or discontinuation of a rate potentially brings us into this territory and indeed some of the decided cases touch on these very points. As mentioned above, the 2006 ISDA Definitions provide a fallback to Reference Bank polling in the event that a given rate disappears from a page, so to a degree direct contractual provision has been made for the eventuality of a rate's discontinuation. On the other hand, as noted above, that fallback might not prove workable in practice. We believe that there is a risk that discontinuation of a rate or changes other than those that are clearly economically immaterial to its calculation, could give grounds for claims of contractual frustration. We urge the authorities to bear this in mind as they contemplate the future of a benchmark, both in its current form or some other, in order to avoid the major market disruption that the uncertainty of any such claims would cause.

Additional analysis would be required to assess the risk of claims under doctrines such as contractual frustration (or any local equivalent) in respect of ISDA Master Agreements governed by anything **other than English law**. We understand that concerns similar to those noted above could arise under New York law. New York or English law is the governing law for most OTC derivatives contracts.

Moreover, there should be **alignment with existing regulatory initiatives**. Particularly, if transactions are to be reported, then existing reporting databases, systems and reporting routes should be leveraged. It would be highly disadvantageous to require another regulatory reporting system from market participants when in most cases they already submit to more than one. Appropriate time should be allowed for introduction of changes. Finally, we encourage policymakers to ensure international coordination and alignment of regulatory changes which relate to international markets.

ANNEX 2: ISDA FIX and other benchmarks used by ISDA members

ISDA FIX

ISDAFIX is the leading benchmark for annual swap rates for swap transactions worldwide. This screen service provides average mid-market swap rates for six major currencies at selected maturities on a daily basis. ISDAFIX rates are based on a midday polling and, in some markets, an additional end-of-day polling of mid-market rates. ISDA established ISDAFIX in 1998 in co-operation with Reuters (now Thomson Reuters) and Intercapital Brokers (now ICAP plc.).

ISDA developed ISDAFIX to facilitate the determination of exercise values for cash-settled swap options. The existence of such a benchmark provides a transparent, readily available value to which parties to a transaction can refer as a settlement rate. Without such a benchmark, it might be necessary to go through the process of calling a number of active dealers for quotes in order to settle transactions. The 2006 ISDA Definitions refer specifically to ISDAFIX rates as a means of settlement of over-the-counter derivatives transactions. In the sample Swaption Confirmation in the 2006 ISDA Definitions (Exhibit II-E), for example, the parties can include 'ISDA Source' - that is, ISDAFIX - as the reference settlement rate under Settlement Terms.

ISDAFIX is also used as a reference rate for cash settlement in connection with early terminations of swap transactions. In addition, dealers often use ISDAFIX as an input when marking their swap portfolios to market.

Beyond their use in settling over-the-counter-traded transactions, ISDAFIX rates are also used as a rate or curve source in various exchange products. LIFFE, for example, uses ISDAFIX as the source of the swap curve in calculating the settlement price of its Swapnote futures contract. In addition, both the Chicago Mercantile Exchange and the Chicago Board of Trade use ISDAFIX as the settlement price in their swap futures contracts. In the United States, the Federal Reserve uses ISDAFIX as the source for USD swap rates in its [H.15 Statistical Release](#).

At present, ISDAFIX provides rates for euro (EUR), Hong Kong dollar (HKD), Japanese yen (JPY), British pound (GBP), Swiss franc (CHF) and U.S. dollar (USD). In addition, ISDAFIX provides USD swap spreads. Contributed rates are collected by Thomson Reuters or ICAP, tabulated and then posted alongside the calculated ISDAFIX rate on the applicable Thomson Reuters screen at various times throughout the day.

In relation to ISDAFIX, contributor member firms are selected by ISDA in consultation with ICAP and Thomson Reuters on the basis of reputation among dealers, credit standing, scale of activity in the relevant market, and expertise in the currency concerned. Dealers that consistently fail to provide rates or provide rates that are off the market will be replaced at ISDA's discretion.

Rate Definition

The contributor is asked to provide a rate which is the mean of where that dealer would itself offer and bid a swap in the relevant maturity for a notional equivalent amount of US \$50 million or whatever amount is deemed market size in that currency for that tenor to an acknowledged dealer of good credit in the swap market. The rate should not be where the dealer sees mid-market away from itself, but should be a function of its own bid/offer spread.

Polling and Computation

The USD contributions are collected by ICAP and the rate is calculated by Thomson Reuters, all other contributions are collected and the rate calculated by Thomson Reuters.

Contributions collected and calculated by Thomson Reuters (CHF, EUR Euribor, EUR LIBOR, GBP, HKD, JPY)

Contributors contribute rates to Thomson Reuters in line with the rate definition above by electronic interface. Contributors are asked to provide rates for the full set of designated maturities of the

given ISDAFIX currency within a polling window. Quotes may be submitted to five decimal places. The published rate will be to three decimal places. In the event of technical difficulties, the Contributor can provide their rate to Thomson Reuters via email or phone. The rates are observed and recorded at the end of the polling window following which Thomson Reuters will calculate the ISDAFIX rates and publish them.

Thomson Reuters will calculate the ISDAFIX rate by eliminating a given number ("topping and tailing") of the highest and lowest rates submitted, and then by calculating a simple average of the remaining rates. A rate will be posted as long as a certain number of contributions ("Minimum Number of Contributions") are received.

In the event a contributor does not provide a contribution for the full set of maturities within a given currency, none of their contributed rates will be included in the ISDAFIX rates for that currency that day.

During the polling window, panel members may update or amend a rate that they have contributed. Following the window, contributed rates can not be amended or withdrawn and are considered final.

Contributions collected by ICAP and the rate calculated by Thomson Reuters (USD, USD Spread)

ICAP collects spread information from contributors via a secure website that contributors log into every morning. Contributors are asked to indicate the USD swap spread as of 11:00 am, in accordance with the criteria set by ISDA as detailed above. At 10:58 am, ICAP will send an email reminder to each contributor reminding them to contribute. At 11:02 am, ICAP will indicate on the secure website a USD swap spread and USD swap rate to serve as a reference point for contributors. This reference point is generated from two sources of information:

- (1) Information contained on Reuters page 19901 at 11:00 am, which reflects the most recent swap spreads from completed trades and executable bids and offers in market size done/posted at ICAP.
- (2) Information reflecting executed trades and executable bids and offers at 11 a.m. for US Treasury securities from ICAP's BrokerTec US Treasury electronic trading platform.

By their nature, because both sources of information reflect completed transactions and/or at-risk trading interest, ICAP considers them to be a useful and meaningful reference point for where the market may be at that point in time.

From 11:00 am to 11:15 am, contributors are able to submit their swap spread information and rate to the secure website. In terms of process, contributors may accept the reference swap spread and/or rate indicated on the website, or submit different values. During this time the ICAP swaps desk monitors dealer participation to ensure that the 10-bank minimum is met. As contributors submit spread and rate information, the values are sent to Thomson Reuters on a streaming basis.

At 11:26 am, Thomson Reuters will calculate the USD ISDA FIX rate by eliminating a given number of the highest and lowest rates submitted, and then by calculating a simple average of the remaining rates. A rate will be posted as long as the Minimum Number of Contributions is received.

For more information: <http://www2.isda.org/asset-classes/interest-rates-derivatives/isdafix/>

Other benchmarks used by ISDA members

ISDA has more than 800 members from 50 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearing houses and other service providers. As a result, our members are using a wide range of benchmarks for different purposes. Among them, the following may be noted:

- EURIBOR and LIBOR are used to price notional interbank loans as a reference for interest rate swaps, as well as to price commercial loans or be the reference interest rate in a retail mortgage or consumer credit contracts;
- EONIA, which indexes actual overnight transaction rates (in euros – just as SONIA does for sterling);
- Overnight Index Swaps ('OIS') are based on an index of overnight rates;
- ISDAFIX, to facilitate the determination of exercise values for cash-settled swap options
- In the commodities markets, exchange-traded benchmarks including CME/ NYMEX and ICE (Oil complex, Natural Gas, soft commodities, metals), CRB (commodities) as well as benchmarks of price reporting agencies (Platts, Argus, ICIS, McCloskey, Point Carbon), are used to price derivatives and hedging instruments.