Recommendation of the National Working Group (NWG) on applying a fallback rate for the WIBOR benchmark in interest rate derivatives

Document of the National Working Group for benchmark reform

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This recommendation ('Recommendation') has been prepared by the Derivatives and Valuation Stream of the National Working Group (NWG) for benchmark reform on the basis of analyses and expert discussions conducted until 15 February 2023. The Recommendation presents the recommended method of replacing the WIBOR benchmark with an Alternative Benchmark in WIBOR-based derivatives in the event where a Fallback Trigger of a permanent nature occurs.

This Recommendation intends to preserve the equivalence of conversion of WIBOR-based derivatives after the occurrence of a Fallback Trigger and does not have an obligatory nature.

As regards the wording of this Recommendation, the guiding principle was to apply standard solutions adopted in the market practice, while using terms that are understandable to market participants. The conduct adopted in the Recommendation serves as a model solution. This Recommendation does not prevent market participants from applying different methods of conversion of WIBOR-based derivatives, in particular when that results from contractual terms which indicate the Rate to be applied to substitute the discontinued WIBOR set out as a rate compounded on the basis of observations of the WIRON rate in a given period and adjusted by an appropriate value of the Spread Adjustment (**the Fallback Rate**). This Recommendation is in line with the standards of conversion of derivatives set out in the ISDA documentation and is not contradictory to the approach developed in other streams.

The terms included in this Recommendation which are written in capital letters have been defined in a glossary published by the NWG in the version as at the date of publication of this Recommendation.

Content of the Recommendation

For the purpose of derivatives, the NWG recommends the use of WIRON as the **Alternative Benchmark**. Based on the above assumption, the WIBOR rates for different maturities should be replaced with appropriate **Fallback Rates** according to the rules provided below.

Unless the parties have agreed otherwise or the transaction terms stipulate otherwise, in the event where a **Fallback Trigger** for WIBOR has occurred, the NWG recommends:

1. applying the *Fallback Rate (WIRON)* indicated in the 2021 ISDA Definitions, the values of which are published by Bloomberg Index Services or its successor, based on the rules set out in the 2021 ISDA Definitions, as a substitute for WIBOR.

2. In the case where applying the method set out in point 1 is not possible, the NWG recommends instead using, as a replacement for WIBOR, a Fallback Rate understood as a **compound interest rate for the appropriate Interest Period based on the WIRON values**, calculated **by a calculation agent, adjusted by the Adjustment Spread calculated and published as at the date of the Fallback Trigger by Bloomberg Index Services, appropriate for the maturity of the replaced WIBOR benchmark.**

   The NWG recommends that the calculation agent set the detailed method of compounding such an interest rate, which should be based on the WIRON interest rates originating as much as possible from the Interest Period for which the compound rate is going to be used with a possible shift of not more than 5 Business Days. Before the method of compounding is applied, it should be communicated by the calculation agent to the parties to the transaction.

   The calculation agent is the entity indicated in the transaction terms or agreed separately by the parties as the calculation agent for the purposes of calculating the amounts due in financial settlements between the parties in relation to the transaction.

Clarifications on the use of the Recommendation

1. The Recommendation is based on the assumption that the possibility of applying the solutions it provides may be conditional upon the specificity of a derivative transaction, as well as legal and regulatory restrictions. Before applying the Fallback Rate, the parties to the transaction should examine the operational and legal possibility of applying the recommended solution. In the opinion of the NWG, both recommended solutions are substitutable for each other. Adopting the solution recommended in point 2 should be, however, dictated by objective reasons that exclude the possibility of applying the solution described in point 1.

2. The Recommendation takes into account the term structure of the WIBOR benchmark applied until now in interest rate derivatives. WIRON is an overnight index so in order to maintain the term nature of the WIBOR benchmark in WIBOR-based derivatives it is deemed appropriate to apply the Fallback Rate calculated as a rate compounded on the basis of the observations of the WIRON rate in a given period and adjusted by the appropriate Spread Adjustment.

3. In order to minimise interest rate risk and maintain the economic equivalence of the Fallback Rate, the conversion method should indicate that the interest payment for the Fallback Rate for the WIBOR benchmark is determined at the end of the Interest Period or after the Interest Period has ended (Interest in arrears).

4. In order to maintain the economic equivalence of the conversion, it is justified to apply the appropriate Spread Adjustment. Taking into account the practices of developed financial markets, the NWG recommends that the appropriate Spread Adjustment is applied, which is calculated according to the ISDA methodology and published by Bloomberg, based on the median of the

daily differences between the replaced WIBOR benchmark and the replacing rate compounded based on the WIRON interest rates for the period of 5 years preceding the occurrence of the Fallback Trigger.

5. This Recommendation is in line with the standards of conversion of derivatives set out in the ISDA documentation. Applying the Fallback Rate in the manner described in point 1 may be limited by third party rights.