Main Elements and Purposes of the ISDA IBOR Fallbacks Supplement and of the ISDA 2020 IBOR Fallbacks Protocol

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Sources

The information contained in this presentation refers to the following sources:

- EU Benchmarks Regulation (Regulation (EU) 2016/1011 of the European Parliament and of the Council of June 8, 2016.
- 2006 ISDA Definitions
- ISDA IBOR Fallbacks Supplement (supplement n. 70 to the 2006 ISDA Definitions)
- ISDA 2020 IBOR Fallbacks Protocol
- ISDA User Guide to IBOR Fallbacks and RFRs
- ISDA/Linklaters webinars – Understanding the new IBOR Fallbacks – (1) Introduction to the IBOR Fallbacks Supplement; (2) Introduction to the IBOR Fallbacks Protocol
- ISDA 2020 IBOR Fallbacks Protocol FAQs

Disclaimer

This presentation has been prepared solely for general information and discussion purposes within the ECB Operations Manager Meeting. The information contained therein does not purport to be accurate or complete, should not be considered a guide or an explanation of all relevant issues in connection with the ISDA IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol and does not constitute or contain legal or other form of advice. Prior to using the ISDA IBOR Fallbacks Supplement / adhering to the ISDA 2020 IBOR Fallbacks Protocol parties should make reference to the relevant original sources in consultation with external professional advisors where necessary and/or appropriate.

Requirements of the EU Benchmarks Regulation (Regulation (EU) 2016/1011 of the European Parliament and of the Council of June 8, 2016.

Article 28(2)

"Supervised entities […] that use a benchmark shall produce and maintain robust written plans setting out the actions that they would take in the event that a benchmark materially changes or ceases to be provided. Where feasible and appropriate, such plans shall nominate one or several alternative benchmarks that could be referenced to substitute the benchmarks no longer provided, indicating why such benchmarks would be suitable alternatives. The supervised entities shall, upon request, provide the relevant competent authority with those plans and any updates and shall reflect them in the contractual relationship with clients".

Supervised entities include, among others, credit institutions and investment firms.

This requirement is in line with IOSCO's Statement on Matters to Consider in the Use of Financial Benchmarks" (January 5, 2018)

Purpose of the ISDA IBOR Fallbacks Supplement and ISDA 2020 IBOR Fallbacks Protocol

- A fallback is a contractual provision addressing such events as the discontinuation of a benchmark. Historically, fallbacks in derivative contracts for key interbank offered rates (IBORs) required the calculation agent to obtain quotations from reference banks if an IBOR is not available on screen.
  In the event of a permanent discontinuation of an IBOR, however, this fallback was not deemed to be sufficiently robust or sustainable.

- ISDA launched the IBOR Fallbacks Supplement to the ISDA 2006 Definitions (the "Supplement") and the IBOR Fallbacks Protocol (the "Protocol") on October 23, 2020

- The Supplement amends ISDA's standard definitions for interest rate derivatives in order to incorporate robust fallbacks for derivatives linked to certain IBORs. These changes came into effect on January 25, 2021. Starting from this date all cleared and non-cleared derivatives referencing the mentioned definitions will include the fallbacks, unless the parties specifically exclude them.

- The Protocol enables market participants to incorporate the revisions to the definitions - the new fallbacks - into their legacy non-cleared derivatives trades with other counterparties that choose to adhere to the Protocol. The Protocol has become effective on January 25, 2021 as well.

ISDA IBOR Fallbacks Supplement: Focus

- The fallbacks for a particular currency will apply following a permanent cessation of the IBOR in that currency. Limitedly to LIBOR, the fallbacks in the relevant currency will also apply following a determination by the FCA that LIBOR in that currency is no longer representative of its underlying market.

- Rate Options are updated in order to include new triggers and fallbacks. Each Rate Option will first fall back to a published fallback rate calculated on the basis of a term adjusted risk free rate ("RFR") for the relevant currency plus a spread; should this published fallback rate also be discontinued, further specific fallbacks are provided.

- The Supplement introduces new Sections on Discontinued Rates Maturities Provisions and on Certain Definitions Relating to Discontinued Rates Maturities
  Given certain circumstances interpolation may be used to determine a rate referencing a discontinued tenor.

- Specific Fallbacks are provided for Calculation Periods to which linear interpolation applies and (SOR, TBHFIX) which are shorter that the Designated Maturity.

Floating Rate Options contained in the 2006 ISDA Definitions being amended by the Supplement, Relevant IBORs and related underlying RFRs

GBP-LIBOR-BBA GBP-LIBOR-BBA-Bloomberg **[Reformed SONIA]**

CHF-LIBOR-BBA CHF-LIBOR-BBA-Bloomberg **[SARON]**

USD-LIBOR-BBA USD-LIBOR-BBA-Bloomberg **[SOFR]**

EUR-LIBOR-BBA EUR-LIBOR-BBA-Bloomberg **EUR-EURIBOR**-Reuters **[€STR]**

JPY-LIBOR-FRASETT JPY-LIBOR-BBA JPY-LIBOR-BBA-Bloomberg

[TONA]

JPY-TIBOR-17097 JPY-TIBOR—TIBM (All Banks)-Bloomberg **JPY-**TIBOR**-ZTIBOR**

AUD-BBR-AU**BBSW** AUD-BBR-BBSW AUD-BBR-BBSW-Bloomberg **[AONIA]**

CAD-BA-**CDOR** CAD-BA-CDOR-Bloomberg **[CORRA]**

HKD-HIBOR-HKAB HKD-HIBOR-HKAB-Bloomberg **[HONIA]**

SGD-SOR-VWAP **[USD/SGD FX + SOFR]** **THB**-THB**FIX**-Reuters **[USD/THB FX + SOFR]**

“all-in” FALLBACK RATE for a certain currency

=

Relevant RFR (term-adjusted by using the compounded setting in arrears rate approach) - daily compounding over observation period generally equivalent to tenor

in order to account for the fact that the IBORs, unlike RFRs, are term rates

+

Spread adjustment (calculated by using the five-year historical median approach) – median of deltas between relevant IBOR and corresponding compounded RFR for relevant tenor observed over a static lookback period of 5 years prior to the Index Cessation Event

in order to account for bank credit risk premia and other differential factors; the spread component is published by Bloomberg Index Services Limited on the date of the Index Cessation Event.

Relevant definitions amended by the Supplement

Index Cessation Event

- A public statement or publication of information by the administrator of the Applicable Rate announcing that it has ceased or will cease, permanently or indefinitely, to provide such rate.
- A public statement or publication of information by relevant regulatory supervisor/central bank/insolvency official/court/resolution authority stating that the administrator of the Applicable Rate has ceased or will cease to provide it permanently or indefinitely.
- (and for LIBOR rate Options only) a public statement or publication of information by the regulatory supervisor for the administrator of such Applicable Rate announcing that (A) such rate is no longer or will no longer be as of a specified future date representative of the underlying market/economic reality and that such representativeness will not be restored and (B) made in the awareness that it will engage certain contractual triggers for fallbacks activated by pre-cessation announcements by such supervisor. (**Pre-cessation Index Cessation Event**)

Index Cessation Effective Date

- The first date on which, in respect of the Applicable Rate and one or more Index Cessation Events, such rate is no longer provided or (LIBOR Rate Options only) is either Non-Representative or no longer provided.

Example of the Structure of the Supplement – EUR Rate Options

EUR-LIBOR-BBA **EUR-LIBOR-BBA-Bloomberg**

- No Index Cessation Effective Date with respect to Euro LIBOR
- Index Cessation Effective Date with respect to Euro LIBOR
- Fallback Index Cessation Effective Date with respect to Fallback Rate (EuroSTR)
- No Fallback Index Cessation Effective Date with respect to EuroSTR
- Fallback Index Cessation Effective Date with respect to EuroSTR
- No Fallback Index Cessation Effective Date with respect to ECB Recommended Rate
- No ECB Recommended Rate or Fallback Index Cessation Effective Date with respect to ECB Recommended Rate
- No Fallback Index Cessation Effective Date with respect to Modified EDFR

EUR-EURIBOR-Reuters **EUR-EURIBOR-BBA-Bloomberg**

- No Index Cessation Effective Date with respect to EURIBOR
- Index Cessation Effective Date with respect to EURIBOR
- Fallback Index Cessation Effective Date with respect to Fallback Rate (EuroSTR)
- No Fallback Index Cessation Effective Date with respect to EuroSTR
- Fallback Index Cessation Effective Date with respect to EuroSTR
- No Fallback Index Cessation Effective Date with respect to ECB Recommended Rate
- No ECB Recommended Rate or Fallback Index Cessation Effective Date with respect to ECB Recommended Rate
- No Fallback Index Cessation Effective Date with respect to Modified EDFR

ISDA 2020 IBOR Fallbacks Protocol: Focus

- As already stated above, the Protocol was published on October 23, 2020 with effective date on January 25, 2021.

- Whereas

- the Supplement allows inclusion of certain triggers and fallbacks in the 2006 ISDA Definitions effective January 25, 2021 and, consequently, in derivative contracts incorporating such definitions from such date onwards;

- the Protocol allows the terms of the Supplement to be extended to Protocol Covered Documents ("PCDs") related to legacy transactions existing between two adhering parties entered into prior to the Protocol Effective Date, or if later, to the Implementation Date (i.e. the date on which ISDA accepts the adherence letter from the later of the two parties).

- The amendments to PCDs made by the Protocol are effective on the later of the Protocol Effective Date and the Implementation Date.

Protocol adherence mechanics

- Adherence is public and is open both for ISDA and non-ISDA members, regardless of where they may be domiciled. It takes place, as for other ISDA protocols, by sending a form of Adherence Letter – which cannot be modified - through the ISDA online protocol system; the letter has then to be accepted by ISDA. Whereas before January 25, 2021 certain protocol fee exclusions existed, adherence following that date always implies the payment of a $500 one-time fee. Bulk adherence fees can be applied in certain cases.

- Specific rules, concerning also fees and the Implementation Date, apply to the agency adherence process (i.e. adherence by an agent on behalf of underlying clients) vs. adherence as principal (i.e. in one's own capacity).

- The ISDA 2020 IBOR Fallbacks Protocol has currently no cut-off date but, as in other cases, ISDA reserves to designate a closing date in the future giving at least a 30 day notice on the dedicated section of its website. A revocation procedure also exists.

- Presently about 13600 counterparties have already adhered to the Protocol.

Documents covered by the Protocol

- ISDA MAs, ISDA Credit Support Documents and Confirmations (and certain non-ISDA MAs and credit support documents listed in the Protocol as Additional MAs and Additional Credit Support Documents) - fulfilling the below criteria:

- Protocol Covered MAs and Protocol Covered Credit Support Documents:

  an ISDA MA or Additional MA or an ISDA Credit Support Document or Additional Credit Support Document entered into by adhering parties and dated prior to the Protocol Effective Date/Implementation Date (as discussed before) that:

  - incorporates a Covered ISDA Definitions Booklet;
  - references an IBOR "as defined" in such Booklet;
  - otherwise provides that the IBOR has the meaning given in such Booklet and/or
  - Includes a reference to a Relevant IBOR howsoever defined (e.g. LIBOR).

Documents covered by the Protocol (2)

- Protocol Covered Confirmations:

  a confirmation entered into by adhering parties and dated prior to the Protocol Effective Date/Implementation Date (as discussed before) that: supplements, forms part of and is subject to or is otherwise governed by a MA that:

  - incorporates a Covered ISDA Definitions Booklet;
  - references an IBOR "as defined" in such Booklet
  - otherwise provides that the IBOR has the meaning given in such Booklet and/or
  - Includes a reference to a Relevant IBOR howsoever defined (e.g. LIBOR).

Non-ISDA Documents covered by the Protocol – Focus

- The Additional Master Agreements and Additional Credit Support Documents covered by the Protocol are defined in it by reference to a dedicated Protocol Annex which lists dozens of such documents (more than 70 MAs, among which various versions of EMA, GMRA and GMSLA, CMOF, FBF and 7 credit support documents).

- The Protocol does not amend any non-ISDA MAs or credit support documents not included in the mentioned list, although parties can always extend the provisions of the Protocol to other documents – or explicitly exclude the application of the provisions to certain documents otherwise in scope of the Protocol - by executing a bilateral agreement.

- It has to be specified that – whilst having interacted with local counsel and trade associations responsible for the non-ISDA documentation listed in the Protocol – ISDA provides no assurance as to the effectiveness of the Protocol as far as Additional MAs and Additional Credit Support Documents are concerned since no dedicated legal due diligence has been conducted by the association itself. Consequently Protocols users may want to seek assurance of effectiveness in such cases by directly contacting local counsel and relevant trade associations.