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LIBOR Cessation: ISDA Launches IBOR Fallbacks Supplement and ISDA 2020 IBOR Fallbacks Protocol

On October 23, 2020, the International Swaps and Derivatives Association, Inc. ("ISDA") launched the IBOR Fallbacks Supplement to the 2006 ISDA Definitions (the "Supplement") and the ISDA 2020 IBOR Fallbacks Protocol (the "Protocol") to address the expected permanent cessation of U.S. Dollar LIBOR ("USD LIBOR") and several other interbank offered rates (together with USD LIBOR, the "Relevant IBORs") at the end of 2021.[1] The Supplement introduces specified cessation events for each Relevant IBOR and specified fallback rates that apply to new contracts following cessation of each Relevant IBOR, while the Protocol allows market participants to amend existing contracts by incorporating the revised definitions in ISDA Master Agreements, repurchase agreements and other trading documentation referencing Relevant IBORs. The Supplement and the Protocol will become effective on January 25, 2021.

In this memorandum, we first describe how the Supplement and the Protocol address the anticipated permanent cessation of the Relevant IBORs, including what constitute "Index Cessation Events," what fallback rates will replace USD LIBOR upon the occurrence of an Index Cessation Event and how a spread adjustment between USD LIBOR and the new fallback rate will be calculated. We next discuss what agreements can be amended by the Protocol, when the Supplement takes effect and some issues market participants may want to consider when adhering to the Protocol. Finally, we describe the timeline and procedure for adhering to the Protocol.

How Do Supplement and Protocol Address the Cessation of Relevant IBORs, in Particular USD LIBOR?

The Supplement and the Protocol amend the 2006 ISDA Definitions and covered trading documentation by providing an industry-endorsed fallback rate for each Relevant IBOR and by describing how the spread adjustment between each Relevant IBOR and the applicable fallback rate will be calculated. The Supplement and the Protocol also specify the index cessation events that trigger a replacement of each Relevant IBOR.

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1 The Supplement also covers sterling Libor, Swiss Franc LIBOR, Euro LIBOR, EURIBOR, Yen LIBOR, Yen TIBOR, Euroyen TIBOR, BBSW, CDOR, HIBOR, SOR and THBFIX. The amendments in respect of each IBOR follow a similar format and methodology but differ in the specifics.

What Index Cessation Events Are Specified?

In both the Supplement and the Protocol, an Index Cessation Event triggers the replacement of the Relevant IBOR with the fallback rate for such Relevant IBOR.

An "Index Cessation Event" includes the permanent cessation of the Relevant IBOR and, for certain Relevant IBORs, a "pre-cessation event" that describes the loss of economic representativeness of such Relevant IBOR:

- a "permanent cessation" occurs when there is a public statement by the administrator of the Relevant IBOR announcing that it has ceased or will cease to provide such Relevant IBOR permanently, or a public statement by the regulatory supervisor for the administrator of the Relevant IBOR (including the central bank for the currency of the Relevant IBOR, an insolvency official or certain other entities with jurisdiction over the administrator for the Relevant IBOR), which states that the administrator of the Relevant IBOR has ceased or will cease to provide the Relevant IBOR permanently; and

- a "pre-cessation event", applicable only to USD LIBOR, Sterling LIBOR, Swiss Franc LIBOR, Euro LIBOR and Yen LIBOR, occurs when there is a public statement by the regulatory supervisor for the administrator of such Relevant IBOR announcing that such Relevant IBOR is no longer, or as of a specified future date will no longer be, representative of the underlying market and economic reality that it is intended to measure and that representativeness will not be restored, and such statement is made with the awareness that it will engage certain contractual triggers for fallbacks activated by pre-cessation announcements by such supervisor (howsoever described) in contracts.

What Is the Fallback Rate for USD LIBOR Upon Occurrence of an Index Cessation Event?

Upon the occurrence of an Index Cessation Event with respect to USD LIBOR, USD LIBOR will be replaced by the term adjusted Secured Overnight Financing Rate ("Fallback SOFR") *plus* a spread.

Bloomberg Index Services Limited ("Bloomberg"), the vendor selected by ISDA to calculate risk free rate adjustments, will calculate and provide the applicable spread adjustment on the Bloomberg Fallback Rate (SOFR) screen. The spread will be determined based on the median spread between USD LIBOR and Fallback SOFR over the preceding five-year period, and on other formulas, rules and conventions set forth in the Bloomberg IBOR Fallback Rate Adjustment Rule Book.[2]

[2] Similarly, the Supplement and the Protocol specify the fallback rate for each other Relevant IBOR and authorize Bloomberg to publish the spreads for other Relevant IBORs.

If Fallback SOFR itself later is subject to a permanent cessation, the Protocol and the Supplement provide four additional fallback rates for Fallback SOFR.[3] The spread for each additional fallback rate will be determined by the calculation agent based on the Bloomberg IBOR Fallback Rate Adjustments Rule Book.[4]

Which Agreements Can Be Amended by the Protocol?

The primary function of the Protocol is to enable market participants to complete a batch amendment of legacy contracts that reference Relevant IBORs.

The Protocol amends all "Protocol Covered Documents," which is defined very broadly to include master agreements, credit support documents and confirmations that reference a Relevant IBOR, whether by incorporating specific definitions booklets published by ISDA (including, in particular, the 2006 ISDA Definitions), defining a Relevant IBOR by reference to one of those definitions booklets, or otherwise. Protocol Covered Documents include the (a) 1992 ISDA Master Agreement, the ISDA 2002 Master Agreement and deemed master agreements; (b) confirmations that are governed by those master agreements; and (c) ISDA's forms of credit support annexes and any other document that guarantees or supports a party's obligation under a Protocol Covered Document.

Notably, "Protocol Covered Documents" also include approximately 75 additional standard trading agreements, including several forms of global master repurchase agreements, master repurchase agreements and master securities loan agreements that either incorporate one of ISDA's specified definitions booklets, define a Relevant IBOR by reference to one of those definitions booklets or otherwise refer to a Relevant IBOR.

"Protocol Covered Documents" excludes, and the Protocol does not apply to, documentation governing cleared derivatives transactions.

When Does the Supplement Take Effect?

The Supplement amends the 2006 ISDA Definitions to include the fallback rates for the Relevant IBORs and the cessation events described above, effective January 25, 2021. Any new contracts executed after

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3 The four additional fallback rates are: (1) SOFR, as administered by the Federal Reserve Bank of New York; (2) Fed Recommended Rate, being the rate (inclusive of any spreads or adjustments) recommended as the replacement for SOFR by the Federal Reserve Board or the Federal Reserve Bank of New York; (3) OBFR, the Overnight Bank Funding Rate provided by the Federal Reserve Bank of New York on the New York Fed's Website; and (4) FOMC Target Rate, the short-term interest rate target set by the Federal Open Market Committee and published on the Federal Reserve's Website. If there is a permanent cessation of the previous fallback rate, the next fallback rate will apply.

4 Similarly, the Supplement and the Protocol provide additional fallback rates for each other Relevant IBOR.

January 25, 2021 that incorporate the 2006 ISDA Definitions will automatically incorporate the Supplement as part of the 2006 ISDA Definitions.

Legacy contracts that incorporate the 2006 ISDA Definitions "as amended by any future supplement to the 2006 ISDA Definitions" also will automatically incorporate the Supplement when it becomes effective on January 25, 2021. Conversely, existing contracts that reference the 2006 ISDA Definitions but do not include future amendments will require a separate amendment to incorporate the new Supplement. The Protocol facilitates this amendment.

What Should I Consider When Adhering to the Protocol?

Many market participants have entered into interest rate hedges under Protocol Covered Documents that hedge a floating interest rate based on a Relevant IBOR under a credit agreement or loan. These market participants should consider if and how the floating interest rate under that credit agreement or loan will be adjusted and how such adjustment will compare to adjustments to the interest rate hedge made through the Protocol. Moreover, if the credit agreement or loan requires consent from the administrative agent or lenders to amend any interest rate hedging instrument, market participants should ensure that appropriate consents are obtained prior to adhering to the Protocol.

In addition, market participants already may have negotiated a bespoke fallback rate or rate adjustment mechanism in their agreements or may want to use the Protocol to amend only a subset of their outstanding transactions. ISDA has published template language that allows market participants to exclude specific documents from the scope of the Protocol as well as include additional documents as Protocol Covered Documents. Market participants also may choose to disapply the pre-cessation triggers included in the Protocol on a bilateral basis using template language published by ISDA.

How Do I Adhere to the Protocol?

How Does the Protocol Amend Protocol Covered Documents?

The Protocol incorporates the amendments to the 2006 ISDA Definitions provided by the Supplement into each Protocol Covered Documents. Once ISDA accepts adherence letters from both parties to a Protocol Covered Document, that Protocol Covered Document will be amended accordingly as of the "Effective Date" of the Protocol.

What Is the Effective Date of the Amendments Implemented by the Protocol?

The amendments implemented by the Protocol will be effective on January 25, 2021, or if one or both of the parties to a Protocol Covered Document adheres after January 25, 2021, the date on which ISDA accepts the adherence letter from the later of those two adhering parties.

What Is the Timeline for Adherence to the Protocol?

Currently, there is no cut-off date by which market participants must adhere to the Protocol. As is typical, however, ISDA reserves the right to designate a cut-off date for the Protocol with at least 30 days' advance notice. After a cut-off date, ISDA will not accept any further adherence letters to the Protocol.

Do I Need to Adhere to the Protocol?

There is no legal or regulatory requirement to adhere to the Protocol, and if your agreement automatically incorporates updates to the 2006 ISDA Definitions, it will be updated when the Supplement becomes effective on January 25, 2021.

Many agreements, however, do not automatically incorporate updates to the 2006 ISDA Definitions or include any bespoke terms addressing IBOR cessation. In this case, market participants may want to consider amending these agreements to address IBOR cessation as other resolutions based on the existing terms of these agreements may be unclear or undesirable. While amendments can be accomplished through bilateral negotiations, the Protocol facilitates amendments in an efficient manner, and consistent with a market standard approach.

How Do I Adhere?

To adhere, market participants need to provide ISDA with an adherence letter through the Protocol section of ISDA's website. Once properly completed and uploaded, ISDA will confirm the approval and acceptance of each adherence letter and publish a conformed copy of the letter containing the name of the adhering principal or agent.

Agents, such as investment managers for investment funds, may adhere to the Protocol on behalf of one or multiple clients. The agent may execute a single adherence letter on behalf of all or a specified subset of the clients for which it has authority to act. Agents adhering on behalf of some but not all of their clients may identify the relevant clients to be bound by the terms of the Protocol through an online platform such as the ISDA Amend platform on IHS Markit.

Adherence letters can be completed on ISDA's website at the following URL (login required): https://www.isda.org/protocols/.

A $500 fee applies for the submission of each adherence letter.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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