

MEMO# 32857

October 23, 2020

LIBOR Update: ISDA Launches Fallback Protocol and Supplement

[32857]

October 23, 2020 TO: ICI Members

ICI Global Members

Derivatives Markets Advisory Committee

LIBOR Transition Working Group SUBJECTS: Compliance

Derivatives

Financial Stability

Operations RE: LIBOR Update: ISDA Launches Fallback Protocol and Supplement

We wanted to alert you to recent developments in the transition from LIBOR from ISDA.

On October 23, ISDA launched new benchmark fallback language that would apply to new derivatives contracts through a Supplement to the 2006 ISDA Definitions^[1] or that counterparties to legacy derivative contracts could adhere to through an IBOR Fallbacks Protocol.^[2] This fallback language would apply a replacement rate to derivatives contracts that reference LIBOR (or certain other IBORs^[3]), which are expected to be discontinued after 2021, upon triggering events described below.^[4]

The Protocol and Supplement will take effect on January 25, 2021.

Fallback Language

ISDA's new fallback language would provide a replacement benchmark rate in the event of a permanent cessation of LIBOR or other IBORs. The replacement benchmark rate would be a term adjusted risk-free rate for the relevant currency plus a spread, which will be published by Bloomberg Index Services Limited.^[5] For US Dollar LIBOR, the replacement rate would be based on the Secured Overnight Finance Rate (SOFR).

In addition, for LIBOR, the fallbacks also contemplate a 'pre-cessation' event. A 'pre-cessation' event is a public statement by the regulatory supervisor for the administrator of LIBOR (currently, the UK Financial Conduct Authority) announcing that LIBOR is no longer, or as of a specified future date will no longer be, representative of the underlying market and economic reality. As of the date of that statement or a statement that LIBOR will permanently cease to be available, the spread component of the replacement benchmark rates would be published. The replacement benchmark rates themselves would apply on the date that LIBOR actually becomes non-representative or actually ceases to be available, whichever is earlier.^[6]

2006 Definitions Supplement

The Supplement is the mechanism by which ISDA will add the new fallback language to its 2006 Definitions, which form the standard terms used in most interest rate derivatives. Once the Supplement comes into effect, all new cleared and uncleared derivatives that reference the 2006 Definitions will automatically incorporate the new fallback language.^[7]

Fallback Protocol

The Protocol is the mechanism by which ISDA will allow counterparties to legacy non-cleared contracts that incorporate the 2006 or 2000 ISDA Definitions or the 1998 ISDA Euro Definitions to include the new fallbacks into their existing trades with other parties that also choose to adhere to the Protocol. The Protocol is open for adherence from the launch date, October 23, 2020.

Bridget Farrell
Assistant General Counsel

endnotes

[1] See Amendments to the 2006 ISDA Definitions to include new IBOR fallbacks, Supplement no.70 to the 2006 ISDA Definitions (Oct. 23, 2020), *available at* http://assets.isda.org/media/3062e7b4/23aa1658-pdf/?_zs=rHJ4P1&_zl=EEa16.

[2] See ISDA 2020 IBOR Fallbacks Protocol (Oct. 23, 2020), *available at* http://assets.isda.org/media/3062e7b4/08268161-pdf/?_zs=rHJ4P1&_zl=FEa16.

[3] IBORs included are the sterling London interbank offered rate, the Swiss franc London interbank offered rate, the US dollar London interbank offered rate, the euro London interbank offered rate, the euro interbank offered rate, the Japanese yen London interbank offered rate, the Japanese yen Tokyo interbank offered rate, the euroyen Tokyo interbank offered rate, the Australian bank bill swap rate, the Canadian dollar offered rate, the Hong Kong interbank offered rate, the Singapore dollar swap offer rate, and the Thai baht interest rate fixing.

[4] ISDA also produced a set of Frequently Asked Questions on the 2020 Fallbacks Protocol (FAQs), *available at* <http://assets.isda.org/media/3062e7b4/3cfa460a-pdf/>. See also ISDA, Understanding IBOR Benchmarks Fallbacks, *available at* http://assets.isda.org/media/50b3fed0/47be9435-pdf/?_zs=rHJ4P1&_zl=DEa16.

[5] See ISDA, Bloomberg, and Linklaters, Fact Sheet: IBOR Fallbacks (<https://assets.bbhub.io/professional/sites/10/Factsheet-IBOR-Fallbacks.pdf>)

[6] See ISDA's FAQs at 5A for an example of the timing of a pre-cessation announcement and cessation event.

[7] For existing cleared derivatives, the new fallback language will also apply automatically to the extent that clearinghouses incorporate these changes into their rulebooks. See, e.g., CME Group Supports ISDA's LIBOR Fallback Provisions (Dec. 21, 2018), *available at* <https://www.cmegroup.com/education/articles-and-reports/cme-group-supports-isda-s-libor-fallback-provisions.html>; LCH's position in respect of ISDA's recommended Benchmark

Fallback Approaches (Dec. 20, 2018), *available at*

<https://www.lch.com/membership/ltd-membership/ltd-member-updates/lchs-position-respect-isdas-recommended-benchmark>.

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