IBOR Fallbacks: ISDA’s Work – Rates and Triggers

• ISDA is currently undertaking work to amend the 2006 ISDA Definitions to implement fallbacks for: LIBOR in GBP/CHF/USD/EUR/JPY, EURIBOR, JPY TIBOR, Euroyen TIBOR, BBSW, CDOR, HIBOR and SOR (the IBORs).

• The fallbacks apply upon the permanent discontinuation of the relevant IBOR (based on pre-determined, objective triggers) and will be to the relevant alternative risk-free rate (RFR), subject to term and spread adjustments. The permanent discontinuation trigger is defined as “Index Cessation Event”* in the non-LIBOR Rate Options.
  • The fallbacks will not apply until the actual discontinuation of the relevant IBOR (if that is after the announcement date). This date is defined as the “Index Cessation Effective Date”.

• For LIBOR in GBP/CHF/USD/EUR/JPY, the fallbacks apply upon the earlier of (i) the permanent discontinuation or (ii) the non-representativeness (as determined by the UK FCA) (a so-called “pre-cessation” event) of LIBOR in the relevant currency (based on pre-determined, objective triggers) and will be to the relevant alternative RFR, subject to term and spread adjustments. The combined permanent discontinuation and pre-cessation trigger is also defined as “Index Cessation Event”** in the LIBOR Rate Options.
  • The Index Cessation Effective Date for the pre-cessation trigger will be the date on which LIBOR in the relevant currency ‘is no longer representative’, which may either coincide with or be after the date of an announcement that it is ‘no longer capable of being representative’. The Index Cessation Effective Date for LIBOR in the relevant currencies will be the earlier of (i) the actual discontinuation or (ii) the date on which LIBOR in the relevant currency ‘is no longer representative’
  • Report analyzing results of 2020 consultation on pre-cessation fallbacks will be published in early May. Information about the consultation and the prior 2019 consultation on pre-cessation fallbacks is available at https://www.isda.org/2020/01/10/benchmark-fallback-consultations/
IBOR Fallbacks: ISDA’s Work – Triggers

• “Index Cessation Event” means:
  – a public statement or publication of information by or on behalf of the administrator of [the relevant IBOR] announcing that it has ceased or will cease to provide [the relevant IBOR] permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide [the relevant IBOR]; or
  – a public statement or publication of information by the regulatory supervisor for the administrator of [the relevant IBOR], the central bank for the currency of [the relevant IBOR], an insolvency official with jurisdiction over the administrator for [the relevant IBOR], a resolution authority with jurisdiction over the administrator for the [the relevant IBOR] or a court or an entity with similar insolvency or resolution authority 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 or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide [the relevant IBOR].

  – [FOR LIBOR ONLY:] a public statement or publication of information by the regulatory supervisor for the administrator of [LIBOR in the relevant currency] announcing [(a)] that [LIBOR in the relevant currency] is no longer, or as of a specified future date will no longer be, capable of being representative, or is non-representative, of the underlying market and economic reality that [LIBOR in the relevant currency] is intended to measure as required by applicable law or regulation and as determined by the regulatory supervisor in accordance with applicable law or regulation [and (b) that the intention of that statement or publication is to constitute a trigger for fallbacks in derivative contracts].

• Statement from the UK FCA regarding announcement of contractual triggers for LIBOR available at https://www.fca.org.uk/markets/transition-libor/libor-contractual-triggers
IBOR Fallbacks: ISDA’s Work – Implementation of Fallbacks in Supplement

Form of Amendments

• **Supplement to the 2006 ISDA Definitions**: To account for any permanent discontinuation of a relevant IBOR, amendments to the floating rate options in Section 7.1 of the 2006 ISDA Definitions for the relevant IBORs will take the form of:

  – a statement identifying the objective triggers that would activate the selected fallbacks (see ‘Index Cessation Event’ on the previous slide); and

  – a description of the fallbacks that would apply upon the occurrence of that trigger, which will be:

    i. the relevant RFR adjusted using methodologies to account for (A) the fact that the RFR is an overnight rate and (B) the various premia included within the IBOR; and

    ii. if the relevant RFR is permanently discontinued, one or more further fallbacks.

Upon publication of the Supplement, all **new** derivative transactions entered into on or after the date of the amendments that incorporate the 2006 ISDA Definitions will include the fallbacks (counterparties will **not** have to take any additional steps).
IBOR Fallbacks: ISDA’s Work – Implementation of Fallbacks in Protocol

Form of Amendments

• **ISDA 2020 IBOR Fallbacks Protocol:** ISDA will also publish a protocol to facilitate inclusion of the amended floating rate options (i.e., the definitions with fallbacks) into *existing* derivative contracts entered into prior to publication of the Supplement.

  – Adherents to the Protocol will agree that derivative transactions that they have entered into *with other adherents* prior to publication of the Supplement will be based on the relevant amended floating rate options in the 2006 ISDA Definitions, notwithstanding when the transactions were entered into.

  – The Protocol will cover those ISDA master agreements, ISDA credit support documents and confirmations that:

    i. incorporate one of several ISDA definitional booklets;

    ii. reference an IBOR as defined in or has the meaning in one of several ISDA definitional booklets; or

    iii. reference an IBOR howsoever defined.

  – The Protocol will also extend to additional non-ISDA master agreements and credit support documents. These documents are under discussion in the ISDA working groups and are subject to confirmation.
IBOR Fallbacks: Adjustments to Fallback Rates

Form of Adjustments

• The RFRs are adjusted (1) to reflect the fact that the IBOR is a term rate and (2) to factor in the embedded bank credit spread element of the IBOR.

• The current methodology is:
  – RFRs are based on the **compounded setting in arrears rate** and the **five year historical median approach to the spread adjustment**.
  – The **compounded setting in arrears rate** is the RFR observed over a period (generally equivalent to the relevant IBOR tenor) and compounded daily. The rate is adjusted whereby the observation period is backward-shifted to allow for the rate to be known prior to the relevant payment date.
  – The **five-year historical median approach to the spread adjustment** is based on the median spot spread between the IBOR and the term-adjusted RFR calculated over a static lookback period of five years prior to the Index Cessation Event. The spread adjustment will be added to the compounded setting in arrears rate (but will not be compounded itself).
  – Information about consultation and results available at [https://www.isda.org/2020/01/10/benchmark-fallback-consultations/](https://www.isda.org/2020/01/10/benchmark-fallback-consultations/)
IBOR Fallbacks: Adjustments to Fallback Rates

Bloomberg will publish (i) the compounded setting in arrears rate, (2) the spread adjustment and (3) the ‘all in’ fallback rate on a daily basis

• Publication will be on an indicative basis (i.e., ‘as if’ the fallbacks were triggered on the publication date)
  • Upon the occurrence of an ‘Index Cessation Event’ for the relevant IBOR, the spread adjustment will be set (but the indicative compounded setting in arrears rate and ‘all in’ fallback rate will continue to change on a daily basis). Contracts will continue to reference the relevant IBOR until the ‘Index Cessation Effective Date’ occurs.
  • Upon the occurrence of an ‘Index Cessation Effective Date’ for the relevant IBOR, contracts that continue to reference the relevant IBOR will reference the ‘all in’ fallback rates (which will include the spread adjustment that was set on the date of the ‘Index Cessation Event’ but with changing compounded setting in arrears rates and ‘all in’ fallback rates)

• Expected Bloomberg publication schedule:
  • Rulebook for final methodology published April 22, 2020. Available at http://assets.isda.org/media/34b2ba47/c5347611-pdf/.
  • Publication of test data expected on an IBOR-by-IBOR basis, starting around the end of April.
  • Full connectivity via Bloomberg terminal, API and Bloomberg website (including for free on a delayed basis) expected around the end of June.

• FAQs (to be updated from time-to-time) available at http://assets.isda.org/media/ddcb20e0/76dd3ab8-pdf/
IBOR Fallbacks: Changes to Documentation

- An example of a rate option in the **Supplement to the 2006 ISDA Definitions for covered IBORs other than LIBOR**:

  This will be equivalent to the existing Rate Option but will include (i) provisions dealing with temporary cessation, (ii) an Index Cessation Event trigger for a discontinuation announcement and (iii) a fallback to compounded RFR plus spread* following an Index Cessation Effective Date for discontinuation.

  * The spread will be calculated with data up to and including the business day before the discontinuation announcement (the “permanent cessation spread”).

- An example of the rate option in the **Supplement to the 2006 ISDA Definitions for LIBOR**:

<table>
<thead>
<tr>
<th><strong>Amended Rate Option: USD-LIBOR-BBA (amended rate option)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>This will be the same as the Rate Option above but will also include a pre-cessation trigger in the definition of Index Cessation Event for a non-representativeness announcement and a fallback to compounded RFR plus spread* following an Index Cessation Effective Date for non-representativeness.</td>
</tr>
</tbody>
</table>

  * If a pre-cessation trigger event occurs, the spread will be calculated with data up to and including the business day before the announcement by the regulator that LIBOR in the relevant currency is no longer capable of being representative (the “pre-cessation spread”).

  * If a discontinuation announcement subsequently occurs, the spread applicable to fallbacks under the 2006 ISDA Definitions will remain the same and will not be subsequently adjusted to account for the discontinuation announcement.

  * If a discontinuation announcement occurs prior to the pre-cessation announcement, the spread will be calculated with data up to and including the business day before the discontinuation announcement (i.e. a “permanent cessation spread” will be used).

  * If a pre-cessation announcement and permanent cessation announcement occur at the same time, compounded RFR plus spread will apply from the earlier to occur of the effective date of the non-representativeness and the effective date of the discontinuation.
See below for an illustration of both the pre-cessation trigger and then, subsequently, the permanent cessation trigger occurring pursuant to the combined “Index Cessation Event” definition.

1: 1 BD prior to Pre-cessation Index Cessation Event

2: Pre-cessation Index Cessation Event, i.e. announcement that index is no longer capable of being representative (and therefore will no longer be representative as of (which may either coincide with 2 or be after 2))

3: Pre-Cessation Index Cessation Effective Date, i.e. index actually is no longer representative

4: Permanent Cessation Index Cessation Event, i.e. announcement that index will permanently cease to be available

5: Permanent Cessation Index Cessation Effective Date, i.e. index actually permanently ceases to be available
**IBOR Fallbacks: Changes to Documentation**

- ISDA will also publish templates for standard modifications to allow, for example, a market participant who does not want the combined pre-cessation and permanent cessation fallback provisions to bilaterally negotiate terms outside of the standard ISDA Definitions and related Protocol.
  - Language could be used in legacy transactions if counterparties (i) both adhere to the ISDA IBOR Protocol, (ii) agree bilaterally to incorporate the terms of the IBOR Fallback Protocol by reference (‘short form bilateral amendment’) or (iii) agree bilaterally to the substantive terms of the IBOR Fallback Protocol, subject to negotiation of those terms (‘long form bilateral amendment’). Exclusion of pre-cessation triggers could apply to (x) all legacy transactions between two counterparties or (y) only certain legacy transactions between two counterparties.
  - Separate language could be used in confirmations for new transactions.

- ISDA intends to design these templates so that they can be produced and negotiated on ISDA Create as well as in traditional paper format.

- As these would be individually negotiated, parties could, for example, agree to deviate from applying a spread adjustment that crystallises and remains the same on 2, provided that 2 occurs before 4.
IBOR Fallbacks: Other Templates and other Materials

• Bilateral amendment in ‘short form’ of ISDA IBOR Fallback Protocol
• Bilateral amendment in ‘long form’ of ISDA IBOR Fallback Protocol
• Template acknowledgment language for transactions entered prior to publication of the IBOR Fallback Protocol
• Template wording for inclusion in (i) confirmations for new transactions or (ii) amendments to legacy transactions (on a counterparty-by-counterparty or transaction-by-transaction basis) between counterparties who adhered to the IBOR Fallback Protocol and/or entered into ‘short form’ or ‘long form’ bilateral amendments
  • Exclude transactions and agree to different fallbacks (e.g., to ‘perfectly match’ hedges)
  • Include enhanced Calculation Agent dispute provisions
  • Include additional documents and/or transactions
  • Exclude the pre-cessation fallbacks for LIBOR
  • Other templates as required/requested
• Potential supplemental amendments to fallbacks for non-linear derivatives (e.g., in arrears swaps, caps/floors, swaptions) – currently seeking feedback on approaches
• FAQs
• Webinars, etc.
IBOR Fallbacks: Looking Ahead

• Later 2020:
  – Full connectivity to Bloomberg indicative fallback rates: Around the end of June 2020
  
  – Publication of final form of Supplement to the 2006 ISDA Definitions and of ISDA 2020 IBOR Fallbacks Protocol (and relevant bilateral templates, FAQs, etc.): Targeting July 2020
  
  – Effectiveness of Supplement to the 2006 ISDA Definitions and of ISDA 2020 IBOR Fallbacks Protocol: 4 months after publication
  
  – ISDA/Bloomberg/Linklaters white paper on fallbacks methodology and relevant contractual provisions: May 2020
USD and EUR Collateral Changes

- CCP PAI and Discounting
  - LCH and Eurex expected to switch PAI and discounting for EUR derivatives on **July 27, 2020**
  - LCH and CME expected to switch PAI and discounting for USD derivatives around **October 16-17, 2020**
  - Terms of change and compensation mechanisms set by individual CCPs

- ‘Interest Amount’ for Non-Cleared Derivatives
  - ‘EONIA Amendment’ includes provisions for bilateral amendments to EUR CSAs, including to change ‘Interest Amount’ from EONIA to €STR
    - ISDA will also publish a template for amending USD CSAs to change ‘Interest Amount’ from EFFR to SOFR

USD and EUR Collateral Changes: Supplement 64 and Updated Matrix for Swaptions

• Supplement 64 to the 2006 ISDA Definitions was published on March 30, 2020 to allow parties to specify an ‘Agreed Discount Rate’ in swaption confirmations for which ‘Cleared Physical Settlement’ or ‘Collateralized Cash Price’ cash settlement method apply. It is available at: https://www.isda.org/a/X67TE/Supplement-64-to-the-2006-ISDA-Definitions.pdf

  – The use of ‘Agreed Discount Rate’ will also be available to any other Transactions that apply ‘Optional Early Termination’ or ‘Mandatory Early Termination’ and specify ‘Collateralized Cash Price’ as the applicable cash settlement method

• The ISDA Collateral Cash Price Matrix was also updated on March 30, 2020 to align the discount rates specified with expected changes in the discount rates used by clearinghouse for euro and US dollar. It is available at: https://www.isda.org/a/o67TE/ISDA-Collateral-Cash-Price-Matrix_30032020.pdf

• ISDA published a Guidance Note explaining the changes introduced by Supplement 64 and the updated Matrix. It is available at: https://www.isda.org/a/217TE/Swaptions-Agreed-Discount-Rate-Supplement-Guidance-Note.pdf
## USD and EUR Collateral Changes: Summary of Supplement 64 and Updated Matrix - Swaptions

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Cleared Physical Settlement</th>
<th>Cash Settlement and Collateralized Cash Price (CCP)</th>
</tr>
</thead>
</table>
| Parties specify both a MAC and an ADR | • Parties agree to compensation if, at the time of exercise of the swaption, the Agreed Discount Rate (ADR) differs from the discounting rate/PAI applied by the Mutually Agreed Clearinghouse (MAC)  
  • If parties cannot agree to the compensation amount by the date on which the underlying swap is to be cleared, then parties cash settle using CCP and ADR | • If MAC applies the same benchmark as the ADR for discounting/PAI at the time of exercise, parties cash settle using MAC discount factors for purposes of CCP  
  • If MAC does not apply the same benchmark as the ADR for discounting/PAI at the time of exercise, parties cash settle using CCP and ADR |
| Parties specify an ADR but not a MAC | • Parties agree on the clearinghouse at the time of exercise of the swaption but there is no obligation to agree to compensation, even if the agreed clearinghouse applies a discounting rate/PAI that differs from the ADR  
  • If parties cannot agree to a clearinghouse, then parties cash settle using CCP and ADR | • Parties cash settle using CCP and ADR |
| Parties specify neither MAC nor ADR | • Parties agree on the clearinghouse at the time of exercise of the swaption  
  • If parties cannot agree on a clearinghouse, then parties cash settle using CCP and the CCP Matrix  
  - If swaption expiration date is on or prior to the relevant CCP transition date: EONIA/EFFR  
  - If swaption expiration date is after the relevant CCP transition date: €STR/SOFR | • Parties cash settle using CCP and the CCP Matrix  
  - If swaption expiration date is on or prior to the relevant CCP transition date: EONIA/EFFR  
  - If swaption expiration date is after the relevant CCP transition date: €STR/SOFR |
| Parties specify a MAC but not an ADR | • Parties clear the underlying swap at the MAC. | • Parties cash settle using MAC discount factors for purposes of CCP |
USD and EUR Collateral Changes: Summary of Supplement 64 and Updated Matrix – OET/MET

<table>
<thead>
<tr>
<th>OET/MET</th>
<th>Cash Settlement and Collateralized Cash Price (CCP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parties specify an ADR</td>
<td>• Parties cash settle using CCP and ADR</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Parties do not specify an ADR</td>
<td>• Parties cash settle using CCP and the CCP Matrix</td>
</tr>
<tr>
<td></td>
<td>- If OET/MET date is on or prior to the relevant CCP transition date: EONIA/EFFR</td>
</tr>
<tr>
<td></td>
<td>- If OET/MET date is after the relevant CCP transition date: €STR/SOFR</td>
</tr>
</tbody>
</table>
Benchmark Reform: Other ISDA Initiatives

• Information about ISDA initiatives available at https://www.isda.org/a/WWXTE/ISDA_BMR-and-Interest-Rate-Reform-Workstreams.pdf (updated on approximately a quarterly basis)

• Register for May 12, 2020 Webinar at https://www.isda.org/event/madrid/benchmark-reform-update-on-isda-and-industry-initiatives-2020-11-03/